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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALEZ, HON. JACK HIGHTOWER, HON. NATHAN L. HECHT, HON. LLOYD DOGGETT, HON. JOHN CORNYN, HON. BOB GAMMAGE, HON. CRAIG T. ENOCH, HON. ROSE SPECTOR, TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION, AND W. FRANK NEWTON, IN HIS OFFICIAL CAPACITY AS CHAIRMAN OF THE TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION,

Petitioners,

v.

WASHINGTON LEGAL FOUNDATION, WILLIAM R. SUMMERS, AND MICHAEL J. MAZZONE,

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Fifty States and the District of Columbia have adopted state law programs known as Interest on Lawyers' Trust Account programs ("IOLTA") to finance access to the legal system for the nation's economically disadvantaged. IOLTA provides financing by aggregating client trust funds that could not otherwise earn interest so that the interest on the combined funds can be utilized by non-profit organizations whose primary purpose is the direct provision of civil legal services to the poor. The questions presented by this petition are:

1. Is interest earned on client trust funds held by lawyers in IOLTA accounts a property interest of the client or lawyer, cognizable under the First or Fifth Amendments to the U.S. Constitution, despite the fundamental precept of IOLTA that such funds, absent the IOLTA program, could not earn interest for the client or the lawyer—a question on which courts of appeals are in conflict?

2. Is there a federal general common law on which a U.S. Court of Appeals may rest a determination whether interest earned on client trust funds held by lawyers in IOLTA accounts is a property interest cognizable under the First or Fifth Amendments to the U.S. Constitution, rather than following principles of comity and federalism that require deference to determinations of the issue by the highest appellate court of the State?

TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

TABLE OF AUTHORITIES

CASES

TABLE OF AUTHORITIES—Continued

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Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-

HON. THOMAS R. PHILLIPS, HON. RAUL A. GONZALEZ, HON. JACK HIGHTOWER, HON. NATHAN L. HECHT, HON. LLOYD DOGGETT, HON. JOHN CORNYN, HON. BOB GAMMAGE, HON. CRAIG T. ENOCH, HON. ROSE SPECTOR, TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION, AND W. FRANK NEWTON, IN HIS OFFICIAL CAPACITY AS CHAIRMAN OF THE TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION,

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The Petitioners, the individual Justices of the Texas Supreme Court, the Texas Equal Access to Justice Foundation, and W. Frank Newton, in his official capacity as Chairman of the Texas Equal Access to Justice Foundation, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit, entered in the above-entitled proceeding on September 12, 1996.

OPINIONS BELOW

The opinion of the Fifth Circuit is reported at 94 F.3d 996 and is reprinted in the Appendix hereto. (App. A). The decision of the District Court is reported at 873 F. Supp. 1 and is also reprinted in the Appendix hereto. (App. B). The order denying Petitioner's request for panel rehearing and the dissenting opinion from the denial of rehearing *en banc* are reported at 106 F.3d 640 and are also reprinted in the Appendix. (App. C).

JURISDICTION

The judgment of the court of appeals was entered on September 12, 1996. Petitioners timely filed a request for panel rehearing and simultaneously requested rehearing from the Fifth Circuit *en banc*. The Petition for Panel Rehearing was denied on February 14, 1997. The Suggestion for Rehearing *En Banc* was denied, with six judges dissenting, on the same day. This Court's certiorari jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND REGULATORY PROVISIONS INVOLVED

The First and Fifth Amendments to the United States Constitution and a relevant federal statute are reprinted in the Appendix hereto. (App. D). Selected orders and regulations promulgated by the Texas Supreme Court are also reprinted in the Appendix. (App. E-G).

STATEMENT OF THE CASE

This petition seeks a resolution of the conflict among decisions of U.S. Courts of Appeals created by the decision of the court of appeals below which held that interest earned on IOLTA accounts is a constitutionally cognizable property interest of Respondents despite the inability of the funds in the accounts to earn interest otherwise. The petition is also concerned with whether the court of appeals below failed to give due deference to state law.

Texas is one of fifty states [1] and the District of Columbia to adopt IOLTA programs. Approximately 130,000 people receive legal services each year in Texas as a result, in part, of the financial resources made available by Texas' IOLTA program. Nationally, the number of people receiving legal services each year funded, in part, by IOLTA programs is 1,700,000. The IOLTA programs generate interest on otherwise unproductive nominal or short-term client funds maintained in attorney trust accounts in financial institutions, and distribute the interest earned on such funds to non-profit organizations whose primary purpose is the direct provision of civil legal services to the economically disadvantaged.

The fundamental precept of these programs is that client funds are not eligible for deposit into an IOLTA account if there is any reasonable expectation that interest can otherwise be earned on these funds for the client. The combination of attorneys' ethical obligations with respect to management of client funds, the economics of operating an interest-bearing demand account, and federal banking regulations prevent clients or lawyers from earning interest on nominal or short-term deposits. A client whose funds are placed in an IOLTA account has no less money, or earning power, or resources, because the money was placed in an IOLTA account. The client's balance sheet does not change according to whether IOLTA-eligible funds are placed in an IOLTA account or a non-IOLTA account.

Although the lawyers or their clients can never expect to earn interest on the funds, the aggregation of the same funds by virtue of an IOLTA program, without the cost of attributing interest to individual clients, can earn interest benefiting IOLTA. The Texas IOLTA Program, like other IOLTA programs, operates on the premise that nominal sums of money, or short-term deposits, held by attorneys on behalf of their clients, constitute an

[1] The Indiana Supreme Court has approved in principle the adoption of an IOLTA program, but the program is not yet operational.

unused economic resource which may be rendered productive by the aggregation of such funds by IOLTA to finance the delivery of legal services to low income persons. Prior to IOLTA, the economic advantage now provided by the aggregation of IOLTA-eligible client funds was available only to the financial institutions which held the funds.

The Washington Legal Foundation mounts, and continues to mount, constitutional attacks upon IOLTA programs across the nation by urging that the interest that can be earned on IOLTA funds constitutes constitutionally cognizable property interests. The case below was one of those attacks.

A. The District Court Proceedings.

Respondents [2] filed their lawsuit in the District Court alleging the Texas IOLTA Program constitutes an impermissible taking under the Fifth Amendment and interferes with their First Amendment rights, basing both claims on an alleged property interest in the actual interest generated in IOLTA accounts and a property right to exclude others from the beneficial use of their funds while deposited in IOLTA accounts. Respondents named as defendants each Justice of the Texas Supreme Court, the Texas Equal Access to Justice Foundation (the "Foundation" is the non-profit organization created by Order of the Texas Supreme Court to operate the Texas IOLTA Program), and W. Frank Newton, in his capacity as Chairman of the Foundation.

In its January 19, 1995 reported Memorandum Order and Judgment, the District Court granted summary judgment for Petitioners on the basis that Respondents have

[2] The Respondents are Michael Mazzone, a Texas resident and attorney licensed to practice by the State Bar of Texas; William Summers, a Texas resident and client with funds deposited in an IOLTA account; and the Washington Legal Foundation whose membership purports to include individuals with similar interests to Messers. Mazzone and Summers.

no constitutionally cognizable property interest at stake, because, but for the IOLTA program, no interest could be earned on the funds in the IOLTA accounts. 873 F. Supp. at 7; Pet. App. p. 30. In so holding, the District Court had more than ample precedent, for it followed the logic of *Washington Legal Found. v. Mass. Bar Found.*, 993 F.2d 962 (1st Cir. 1993) and *Cone v. State Bar of Florida*, 819 F.2d 1002 (11th Cir.), *cert. denied*, 484 U.S. 917 (1987). The District Court also noted that its holding was consistent with decisions by the highest appellate courts of seven states that have addressed the issue.[3] Pet. App. pp. 33-34.

B. The Decision of the Court of Appeals.

When it handed down its reported decision on September 12, 1996, the Fifth Circuit departed from the holdings of its sister circuits and other courts that have analyzed the IOLTA process against constitutional standards. 94 F.3d 996; Pet. App. p. 1. The Fifth Circuit cited the generic rule of state law that "interest follows principal" and relied on this Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980) to find that a property right existed in the actual interest generated in an IOLTA account. 94 F.3d at 1002; Pet. App. p. 12. The Fifth Circuit reached the conclusion that such

[3] *Petition by Mass. Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715 (1985); *In re Adoption of Amendments to C.P.R.D.R. 9-102 IOLTA*, 102 Wash.2d 1101 (Wash. 1984); *In re Interest on Lawyers' Trust Accounts*, 279 Ark. 84, 648 S.W.2d 480 (1983); *In re Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); *In re New Hampshire Bar Ass'n*, 122 N.H. 971, 453 A.2d 1258 (1982); *In re Minnesota State Bar Ass'n*, 332 N.W.2d 151 (Minn. 1982); *In re Interest on Trust Accounts*, 402 So.2d 389 (Fla. 1981); *see also Carroll v. State Bar of Cal.*, 166 Cal. App. 3d 1193, 213 Cal. Rptr. 305 (Cal. Ct. App. 1984), *cert. denied sub nom., Chapman v. State Bar of California*, 474 U.S. 848 (1985) (intermediate California appellate court upheld IOLTA against constitutional challenge).

a property right was cognizable under the Constitution even though Respondents could not actually receive interest income on the nominal or short-term client trust funds tendered to attorneys under any set of circumstances. 94 F.3d at 1002-1003; Pet. App. pp. 12-13. The Fifth Circuit did not discuss the Texas Supreme Court's finding that on client funds eligible for deposit in an IOLTA account, interest income cannot reasonably be earned to benefit individual clients for whom the funds are held. Pet. App. p. 56.

Petitioners promptly filed a Petition for Panel Rehearing and a Suggestion for Rehearing *En Banc*. Both Petitions remained pending before the court of appeals for over four months, but were eventually denied on February 14, 1997 in a reported Order, over the dissent of six members of the court. 106 F.3d 640; Pet. App. p. 41.

A judgment of this Court reversing the Fifth Circuit's decision will result in a final judgment upholding the constitutionality of the IOLTA program, keeping the door open to justice for all.

REASONS FOR GRANTING THE WRIT

The public is debating whether justice is truly "for all" or only those who can afford the price of admission. That debate is fueled not only by a greater public awareness of the legal system at work brought on by the recent tendency to televise high publicity trials, but, also, by the growing belief that the legal system should make itself more accessible to the legal needs of our citizens regardless of their financial status. Long before the current clamor was heard, though, the state bodies regulating the legal profession adopted programs to finance legal services to low income persons without imposing a tax, assessing a fee or subjecting costs upon anyone. These were the IOLTA programs adopted by all fifty states and the District of Columbia. IOLTA has helped over a million people

across the nation obtain civil legal services. Attorneys maintained client trust accounts long before IOLTA programs were instituted. Commencement of these programs did not alter pre-IOLTA expectations of lawyers or clients with regard to the ability to earn interest on lawyers' client trust accounts. IOLTA programs are a superb example of government innovation *at the state level* providing an important public benefit largely through the private sector with absolutely no economic sacrifice by clients, by the public or by lawyers. There can be no doubt that the nation has a significant population of economically disadvantaged persons who cannot afford basic access to the legal system on their own. Nor can there be any doubt of the importance to those who, with pride, describe our body politic as a nation of laws, that this basic access be unencumbered by the barrier of economic disadvantage. A right sought to be protected through the legal system may be unpopular to some, but the right to access the legal system for its protection is important to all. Unfortunately, the financing of such access by IOLTA is under attack. Because of the opinion below, the attack will spread.

I. THIS COURT SHOULD RESOLVE THE CONFLICT AMONG THE CIRCUITS OVER WHETHER THE INTEREST GENERATED BY IOLTA PROGRAMS IS A PROPERTY INTEREST BECAUSE THE RESULTING UNCERTAINTY CALLS INTO QUESTION IMPORTANT PROGRAMS ADOPTED IN ALL FIFTY STATES AND THE DISTRICT OF COLUMBIA

The keystone of IOLTA is that a client's funds are not eligible for deposit into an IOLTA account if there is any reasonable expectation that interest can be earned on these funds for the client. Some client funds are not capable of earning interest outside of an IOLTA account. Any one client's funds may be too small in amount, or deposited for too short a time, to earn interest that can

be attributed to the client. However, aggregated under the auspices of IOLTA *without the cost of attribution* of the interest to specific clients, the same funds are able to generate interest where none could exist otherwise. The interest earned on an IOLTA account is the fruit of the aggregation, under the IOLTA Rules, of a client's funds with other clients' funds.

Indeed, Respondent Summers admitted that his attorney told him that his retainer deposited in an IOLTA account was most likely not capable of yielding interest in excess of the costs of establishing and maintaining a separate interest-bearing account. (R. Vol. 5, p. 770.) Despite the fact that Respondent Summers lost no interest income, Respondents attack IOLTA programs arguing that the interest that can be earned in IOLTA accounts constitutes a constitutionally cognizable property interest. The Fifth Circuit's decision below fractured IOLTA's keystone by acceding to that argument and created a conflict on that precise issue with two other U.S. Courts of Appeals.

A. Fifty States And The District Of Columbia Adopted IOLTA Programs To Provide Access To The Legal System Largely Through The Private Sector.

The creation of the Texas IOLTA Program did nothing to change the pre-IOLTA economic expectations of clients with respect to nominal or short-term funds tendered to their lawyers. Historically, such client funds shared three characteristics. First, deposits were aggregated into "trust accounts" held by attorneys in their law firms' names, rather than being deposited on an individual client basis. (R. Vol. 3, pp. 419.) Second, clients did not earn interest income on the funds deposited with their attorneys because rules of professional conduct required that client funds be delivered *on demand* at the client's direction and banks did not pay interest on demand accounts. (R. Vol. 3. pp. 419.) Finally, rules of professional conduct prohibited attorneys from benefiting in any way from their

clients' trust accounts. (R. Vol. 3, pp. 419.) The Texas Rules of Professional Responsibility mirrored these three universal principles. State Bar Rules, art. XII, § 8, DR 9-102 (Texas Code of Professional Responsibility) (1982); Pet. App. pp. 60-61. Accordingly, neither lawyers nor their clients traditionally received interest income from the deposit of clients' funds in a bank.

Under the current rules, Texas lawyers must still place client funds in trust accounts, cannot pool clients' funds in order to benefit themselves from the interest earned,[4] and must maintain client funds in such a fashion that they can be delivered at the client's direction on demand. TEX. DISCIPLINARY R. PROF. CONDUCT 1.14, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G (Vernon Supp. 1997) (State Bar Rules, art. X, § 9; Pet. App. pp. 59-60. Absent IOLTA, any benefit from client funds incapable of yielding net interest to the individual client accrues, by default, only to the depository financial institutions who are able to use the funds without paying interest to anyone.[5] (R. Vol. 3, pp. 419-420.)

IOLTA was made possible by the federal authorization of NOW accounts. Until the advent of Negotiable Order of Withdrawal ("NOW") accounts authorized by the 1980 amendments to federal banking regulations, lawyers were unable to deposit client funds in interest-bearing ac-

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[4] If an attorney "owned" the interest earned on client funds, that interest would be commingled in the account with the clients' principal as the interest accrues in the account until withdrawn.

[5] Because money is fungible, the transaction between depositor and bank is not a bailment of the actual funds placed in the bank. Rather, the depositor becomes the bank's creditor and is entitled to withdraw funds in the amounts specified in their depository agreement. *See In re Nat Warren Contracting Co.*, 905 F.2d 716, 718 (4th Cir. 1990) (holding that bank acquires legal title to funds once deposited), and *United States v. Banco Cafetero Panama*, 797 F.2d 1154, 1158 (2d Cir. 1986) (recognizing that a bank is not a bailee of depositors' funds). Accordingly, the banks are free to pool deposits and obtain any consequent benefits.

counts for the benefit of their clients because interest-bearing demand accounts were not available. 12 U.S.C. § 1832. NOW accounts are basically interest-bearing checking accounts and are suitable for use as client trust accounts because the principal can be returned to the client on demand. (R. Vol. 3, p. 386.) NOW accounts may consist ". . . solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for . . . charitable . . . purposes and which is not operated for profit." 12 U.S.C. § 1832(a)(2).

Even with passage of the NOW regulations, lawyers receive trust funds from clients that are incapable of earning interest in a demand account. Not all clients are eligible depositors under the NOW regulations, because corporations and partnerships are not eligible for NOW accounts. Further, some client funds are either too small in amount, or, are to be held for too short a period of time to earn interest in a single demand account. Finally, even pooling all client funds in a single NOW account does not bestow interest-earning capability on all client accounts. For example, all participants in the pooled account must be eligible depositors under the NOW regulations (*i.e.*, not corporations or partnerships). Moreover, even if all participants in the pooled account are eligible depositors, the costs of subaccounting the funds to attribute the interest to each client may exceed the interest earned on each particular client's funds.

IOLTA overcomes these obstacles in several ways. First, funds from otherwise ineligible depositors, such as partnerships or corporations, can lawfully be pooled together in an IOLTA account, because all of the interest belongs to an eligible non-profit organization, such as the Texas Equal Access to Justice Foundation. (R. Vol. 3, p. 386.) Second, funds of individuals that could not yield net interest in a non-IOLTA pooled account can be pooled in an IOLTA account unburdened by the administrative costs of attribution to individual owner-clients.

The Internal Revenue Service ("IRS") attributes the interest that then accrues in such an IOLTA account to the non-profit organization. Because such interest is not income to the client, the IRS does not tax the client. (R. Vol. 3, pp. 422-423.)

IOLTA programs do not require that clients deposit trust funds with their attorneys. That decision, just as it was before the commencement of IOLTA, remains with the discretion and agreement of the individual client and attorney. Moreover, IOLTA itself imposes no interference or restriction upon the client's use of, or access to the principal amount of the funds deposited in the trust account. The Texas IOLTA Program merely requires lawyers, choosing to accept client funds, to deposit the client funds in an IOLTA account when no account is available that will yield net interest to the client. IOLTA Rule 4; Pet. App. p. 57.

Under the Texas IOLTA Rules, when a client presents a lawyer funds to be placed in a trust account, the lawyer must make an initial determination whether such funds can be deposited into an account capable of returning net interest to that client. IOLTA Rule 6; Pet. App. pp. 57-58. If an account is available in which net interest can be earned by the client, the lawyer *must* deposit the client funds into that account. (R. Vol. 4, p. 529.) By definition, a client's moneys may not be placed in an IOLTA account if the moneys could earn interest for the client outside of the IOLTA account. The Texas IOLTA Rules do not impair an attorney's ability to establish interest-bearing accounts currently authorized by applicable banking laws to earn interest for clients. IOLTA Rule 6; Pet. App. pp. 57-58. As the District Court correctly concluded, "the only funds eligible for deposit in an IOLTA account are those that have no reasonable possibility of legally generating net interest income benefiting the client." 873 F. Supp. at 4; Pet. App. pp. 23-24. In determining the cost of maintaining the account, attorneys are directed to consider the bank's service charges and

the lawyer's accounting costs and tax reporting costs that would be incurred. IOLTA Rule 6; Pet. App. pp. 57-58. If the client funds deposited in an individual or pooled account *can* earn interest above and beyond such costs and charges, and, thus, earn a net return to the client in *any* amount, the funds may not be deposited into an IOLTA account.[6] (R. Vol. 4, p. 529.) This includes funds deposited with a bank that offers subaccounting services. Nothing about the Texas IOLTA Program prohibits attorneys from employing subacccounting services or any other legal and ethically permissible means of maintaining client funds in such a manner that interest, net of expense, can accrue to the benefit of their clients.

B. The Fifth Circuit's Decision Has Created A Conflict Over Whether Interest Earned On Client Trust Funds Deposited in An IOLTA Account Is A Property Right Cognizable Under The Constitution Even Though The Owners Of Such Funds Could Not Reasonably Expect To Receive Such Interest.

The Fifth Circuit held that interest earned on IOLTA accounts is the property of the clients whose money is held in those accounts. This ruling conflicts with decisions in the First and Eleventh Circuits and the highest appellate courts of seven states. Moreover, the ruling was made without due regard for Texas law as discussed in Part II, *infra*. This conflict arises because the Fifth Circuit misinterpreted this Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980) to recognize a compensable property right in interest generated on deposited funds even when the owners of the funds could not reasonably expect actual receipt of the

[6] To effect the placement of the funds in accordance with IOLTA Rule 4, the attorney instructs the depository institution to remit the interest earned, less the bank's reasonable service charges, to the Foundation. IOLTA Rule 9; Pet. App. p. 58. The IOLTA Funds are subsequently distributed by the Foundation in the form of grants to non-profit organizations whose use of IOLTA funds are asessed pursuant to ABA standards.

interest. *Webb's* does not stand for that proposition. The First and Eleventh Circuit courts and four of the seven state courts have correctly held that the rule in *Webb's* was limited to the deposit of funds under facts entirely distinct from the deposit of funds in an IOLTA program.[7]

Webb's involved a challenge to a Florida statute governing the management of funds interpleaded in the registry of a court. The statute authorized court clerks to deposit interpleaded funds in interest-bearing accounts, but also declared that any interest earned on such funds while deposited in the court should be deemed the property of the court. *Id.* at 156-157. Another statute authorized the court clerk to deduct an administrative fee for managing the funds while on deposit. *Id.* at 157. The appellant in *Webb's* had filed an interpleader action involving competing claims to $1 million and deposited the funds at issue in the court registry. By the time the court released the funds for disbursement, the interest earned on the interpleaded fund exceeded $100,000. *Id.* at 158. The court clerk retained the interest pursuant to the statute, and suit was brought challenging that action as a taking. The Florida Supreme Court held the statute constitutional, finding that there was no taking of private property because the interest earned on interpleaded funds by virtue of the state statute was public money. A direct appeal was taken to this Court.

This Court stated that *Webb's* presented the issue "whether it is constitutional for a county to take as its

[7] While all seven state courts and a California appellate court held that interest on IOLTA accounts was not clients' property, the Supreme Courts of Arkansas, Minnesota and Utah so held without discussing *Webb's*. One state court intimated in *dicta* that IOLTA interest proceeds belong to clients. *In re Ind. State Bar Ass'n's Petition to Authorize a Program Governing Interest on Lawyers' Trust Accounts*, 550 N.E.2d 311, 312-315 (Ind. 1990). As mentioned *infra*, the Indiana Supreme Court has since approved in principle adoption of an IOLTA program, but the program is not yet operational.

own, under the authority of a state statute, the interest accruing on an interpleader fund deposited in the registry of the county court, when a fee, prescribed by another statute, is also charged for the clerk's services in receiving the fund into the registry." *Id.* at 155-156. Stating that the "usual and general rule" is that interest on an interpleaded and deposited fund follows the principal, this Court held that the interest on such funds was private property. *Id.* at 162-164. This Court held that "under the narrow circumstances of this case" the county's taking of interest in excess of a clerk's fee for services rendered violated the Fifth Amendment. *Id.* at 164-165. Accordingly, *Webb's* recognized a compensable property right *in net interest.*

Despite its limited holding, various litigants, including Respondents, have relied on *Webb's* to challenge IOLTA as appropriating property because of its recitation of the general rule that interest follows principal. The Fifth Circuit in this case agreed and held that *Webb's* created a rule "independent of the amount or value of interest at issue" and, therefore, Respondents had a property right to the interest that accrued in IOLTA accounts. 94 F.3d at 1002; Pet. App. p. 12.

Numerous courts analyzing the IOLTA process after *Webb's*, however, have held that IOLTA does not implicate constitutionally protected property rights. The analysis of the IOLTA process by the Eleventh Circuit in *Cone v. State Bar of Fla.*, 819 F.2d 1002 (11th Cir.), *cert. denied*, 484 U.S. 917 (1987) is exemplary of the decisions by the courts reaching a contrary conclusion from the Fifth Circuit. The court in *Cone* squarely addressed the issue whether the interest earned on nominal or short term funds held in an IOLTA account was the property of the client for the purposes of the Fifth Amendment under *Webb's*. *Cone*, 819 F.2d at 1004. The court held that the client had no constitutionally cognizable property interest, because she failed to show a claim of entitlement

to the interest based upon substantive law or mutually explicit understandings. The court agreed with the conclusion of the district court that such a claim of entitlement could not be shown because of the economics of running an interest-producing trust account and restrictions that federal banking law places upon NOW accounts. *Id.* at 1005. According to the court, the IOLTA program satisfies the NOW restrictions against corporations and partnerships having NOW accounts by making a nonprofit organization the sole recipient of interest. The court also noted that making one entity the recipient of the interest allowed funds to be aggregated without the need for accounting for the earnings on the funds of individual clients, thus allowing the interest earned to exceed bank charges. *Id.* at 1006. Given the practical, economic and regulatory impediments, the court concluded that a client simply had no legitimate expectation to receive interest on nominal or short term funds tendered to an attorney because such funds were not capable of earning interest for the client regardless of the nature of the account in which the lawyer might deposit the funds. *Id.* at 1006.

Noting a "superficial similarity" between the IOLTA process and the deposit of funds in *Webb's*, the court in *Cone* correctly held that the crucial distinction between *Webb's* and IOLTA was that the facts in *Webb's* led to a legitimate expectation of net interest exclusive of administrative costs and expenses. *Id.* at 1007. The court agreed with the district court that the funds deposited in an IOLTA account had no "net value" to the client, hence there was no property interest for the state to appropriate. *Id.* By combining all deposits with IOLTA as the sole beneficiary, "interest income had been created which was not within the legitimate expectation of the owner of any one of the principal amounts." *Id.* at 1007.

In *Washington Legal Found. v. Mass. Bar Found.*, 993 F.2d 962 (1st Cir. 1993), the First Circuit analyzed the process by which IOLTA generates interest and found,

in discussing the plaintiff's First Amendment claim, that the interest does not belong to clients because it is generated by "an anomaly created by the practicalities of accounting, banking practices, and ethical obligations of lawyers." *Mass. Bar Found.*, 993 F.2d at 980. Accordingly, the First Circuit held that "interest generated by funds deposited in IOLTA accounts is not the clients' money." *Id.* In discussing the Fifth Amendment taking claim, the First Circuit found that *Webb's* did not apply because it involved a "recognized property right to the interest earned while the funds were held in the county registries," and that plaintiffs had no such property right to the interest earned on their funds in IOLTA accounts.[8] *Id.* at 975.

The District Court in the present case thoughtfully reviewed the IOLTA process and its context and held that no property interest was implicated to support Respondent's constitutional claims. 873 F. Supp. at 10; Pet. App. p. 37. It correctly distinguished *Webb's* and found that unlike the claimants to the interest earned by a $1 million fund in *Webb's*, interest accrues in IOLTA accounts *only* when the owners of the fund have no reasonable expectation to earn interest income on the deposited funds elsewhere. 873 F. Supp. at 7; Pet. App. pp. 29-30.

The Fifth Circuit expressly held that the District Court and the opinions in *Cone* and *Mass. Bar Found.* were wrong, concluding that *Webb's* recognizes a property right to the interest the moment it accrues in the bank, regardless whether there is any expectation by the depositors to ever receive it. 94 F.3d at 1002-1003; Pet. App. pp. 12-13. This Court should grant the writ to resolve this conflict and confirm *Webb's* intended reach.

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[8] Moreover, the First Circuit further distinguished *Webb's* because the plaintiffs in that case, Respondent Washington Legal Foundation, did not claim a property right to the interest earned on IOLTA accounts but "eschewed a right to the interest itself." *Id.* at 973.

C. The Significance Of This Case Is Not Limited To The IOLTA Context But Raises Broader Questions Under The Fifth Amendment.

This Court's takings analysis is triggered only by a showing of a reasonable expectation of a property interest. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1019, n.8 (1992); *Penn Central Trans. Co. v. City of New York*, 438 U.S. 104, 124-125 (1978). Individuals are not entitled to constitutional protection of unilateral expectations or abstract claims. *Webb's*, 449 U.S. at 161.

The Fifth Circuit held, however, that clients have a property right to the interest earned in IOLTA accounts because the interest accrues in the bank before deduction of expenses. 94 F.3d at 1003; Pet. App. p. 13. Thus, the court held that a property right attaches to this "gross" interest because "interest follows principal" and remains attached to the interest even if completely offset by administrative expenses. This holding amounts to a finding that a compensable property right exists in the interest generated on a fund in all contexts regardless of the reasonable expectations of the owners of the fund.

In so holding, the Fifth Circuit failed to distinguish between the accrual of interest in the abstract, and the ability of money to earn interest proceeds to which the depositors were entitled. The holding disregards this Court's requirement that there must be a reasonable expectation of property given the economic factors present, in order for a claimed property right to rise to constitutional dimension. *Lucas*, 505 U.S. at 1019, n.8; *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 577 (1972) (must have a legitimate claim of entitlement to be protectable property interest). Even *Webb's* reflected that "a mere unilateral expectation or abstract need is not a property interest entitled to protection." *Webb's*, 449 U.S. at 161. The costs of earning interest cannot be separated from the accrual of interest, for the reasonable expectation of the owner of the principal cannot be to disregard the necessary costs of earning the

interest. No reasonable person would consider that she could earn interest on funds if the costs of doing so would exceed the expected interest to be earned. To exclude such costs from consideration would ignore economic reality and require one to engage in the kind of "abstract" property theory decried by this Court. *Id.*

The Fifth Circuit also failed to consider the high degree to which personal property in general, or interest on bank deposits in particular,[9] is subject to regulation and control by the sovereign. These kinds of regulation define personal property owners' reasonable expectations. As the Court explained in *Lucas*, "in the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, [the owner] ought to be aware of the possibility that new regulation might even render his property economically worthless." *Lucas*, 505 U.S. at 1027-1028. Incidental burdens on the prospective use of personal property are "borne to secure 'the advantage of living and doing business in a civilized community'" and thus are not regarded as a "taking" requiring compensation. *Andrus v. Allard*, 444 U.S. 51, 67 (1979) (quoting *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 422 (1922) (Brandeis, J., dissenting)). As set forth above, client trust fund regulations in place well before the inception of IOLTA prevented lawyers or clients from expecting to earn interest on nominal or short-term funds. IOLTA merely shifts the benefit of interest accrual from financial institutions to a non-profit organization. The creation of NOW accounts did not lead clients to expect they would receive interest income on such accounts regardless of the amount deposited. In fact, IOLTA funds are defined by the lack of such expectation. Yet,

[9] For example, financial transactions have traditionally been subject to state regulation. While most states impose an income tax on interest, *e.g.*, Jerome R. Hellerstein & Walter Hellerstein, *State Taxation I* § 9.10 (2d ed. 1993), no one would seriously suggest that this is an unexpected phenomenon, much less a "taking" requiring "just compensation."

the Fifth Circuit virtually ignored the significance of the regulatory context in which client trust funds are deposited, and simply relied on the rule "interest follows principal."

The Fifth Circuit's opinion abandons the "reasonable expectation" component of this Court's takings analysis and creates a split among the circuits as to whether such component remains a requirement of this Court's takings analysis. The Court should grant the writ to resolve such conflict.

II. THE FIFTH CIRCUIT'S ANALYSIS AND DECISION CONFLICT WITH IMPORTANT PRINCIPLES OF COMITY AND FEDERALISM

This Court has frequently recognized the need to respect the division of the state and federal judiciaries into their own spheres of delegated authority. It is important to a cooperative judicial federalism to avoid federal court error in deciding state-law questions antecedent to federal constitutional issues wherever possible. *Arizonans for Official English v. Arizona*, 65 U.S.L.W. 4169 (March 3, 1997) (urging resort to certification where federal court is asked to construe "a novel state Act not yet reviewed by the State's highest court").[10] In this case, the Fifth Circuit ignored the expectations of a co-equal sovereign by supplanting findings of the Texas Supreme Court with its own determination of policy in lieu of state law. This hardly comports with a fair notion of comity, much less with the Rules of Decision Act. *See* 28 U.S.C. § 1652. Although the Fifth Circuit began its consideration whether a property right existed in the interest on an IOLTA account

[10] On motion for rehearing, Petitioners suggested that, if the Fifth Circuit was not persuaded that the Texas Supreme Court had already spoken authoritatively on the issue in its Order adopting the Texas IOLTA Program and when it passed the rules establishing the program, certification of the question whether state law recognized a property interest in interest on IOLTA deposits should be made to the Texas Supreme Court.

with a generic statement from Texas law, "interest follows principal," its discussion of Texas law of property ended abruptly. The Fifth Circuit panel failed to note that the generic rule of "interest follows principal" has its exceptions. For example, while Texas law respects the property of a spouse held before marriage as separate property subject to his or her exclusive control, the interest earned on separate property during marriage is community property and may be distributed to the other spouse in the discretion of the court upon divorce. *E.g., In re Levi*, 183 B.R. 468, 472 (Bankr. N.D. Tex. 1995); *Mortenson v. Trammel*, 604 S.W.2d 269, 275 (Tex. Civ. App. — Corpus Christi 1980, writ ref'd n.r.e.); *Lesage v. Gaeley*, 287 S.W.2d 193, 196 (Tex. Civ. App. — Waco 1956, writ dism'd). Hence, interest, under Texas property law, does not always follow principal in the context of community property. Indeed, an earlier Fifth Circuit panel reached the same conclusion. *Broday v. U.S.*, 455 F.2d 1097, 1099-1100 (5th Cir. 1972) (applying Texas law). A decision defining property rights under state law should be the constitutional prerogative of the state, not that of a federal court making its own policy determinations.

Rather than explore the rationale upon which the Texas Supreme Court founded the Texas IOLTA Program and the property interest implications of that rationale, the court of appeals below embarked on its own policy-making analysis and concluded that it did not agree, for its own policy reasons, with the premises upon which IOLTA is based. For example, under the Texas IOLTA Program, like IOLTA programs across the nation, tax reporting costs are an important determinant in whether particular funds are eligible for an IOLTA account. However, rather than giving deference to the Texas Supreme Court's determination of rights to interest on client funds, the court of appeals below decided it was "short-sighted" and "unacceptable" to rely upon a "fickle" tax code. The court stated: "we also note that under the current IOLTA program, tax law seemingly defines property . . . [w]e find

no basis to hinge property interests on the fickle tax code. . . . [t]his short-sighted view of property renders it unacceptable." 94 F.3d at 1004 n.47; Pet. App. pp. 16-17. Moreover, the court of appeals decided that it was unwise for the Texas Supreme Court to capitalize on an anomaly in banking regulations in creating the Texas IOLTA program: "we are also hesitant to declare that such interest is not property lest we incite a new gold rush, encouraging government agencies to dissect banking regulations to discover other anomalies that lead to 'unclaimed' interest." 94 F.3d at 1003; Pet. App. p. 15.

In determining state law, however, federal courts must follow the rules of decision of the state courts, particularly the highest appellate courts of the states. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), *see also Or. ex rel. State Land Board v. Corvallis Sand and Gravel Co.*, 429 U.S. 363, 378-379 (1977) (property ownership is not governed by a general federal law but by state law) (Rehnquist, J.). The Fifth Circuit made virtually no effort to explore Texas property law or any expectations, reasonable or otherwise, that a client might have to a proportional share of aggregated interest on a deposit that could not yield net interest on an attributed basis. Instead, the Fifth Circuit deemed all interest to be property of the beneficial owner of the principal, relying exclusively on a decision of this Court, whose facts were clearly distinguishable. The Texas Supreme Court, however, had specifically approved of the Texas IOLTA Program after *Webb's* was decided. In fact, in its Order amending the State Bar Rules thereby creating the Texas IOLTA Program, the Texas Supreme Court specifically found that

> on certain client funds held by attorneys, interest income cannot reasonably be earned to benefit individual clients for whom the funds are held. . . .

(Appendix F). The IOLTA program in Texas and in other states was specifically crafted so as to reach only those deposits that, standing alone, could not generate

interest income in excess of the cost of administrative fees. Thus, the only expectation of interest on these funds results from their being aggregated into a pooled account benefiting a single eligible non-profit organization. Had the Fifth Circuit deferred to the state court's findings on this antecedent question of state law, the constitutional questions presented would not arise. By removing state law from the analysis (or simply affording the state's highest court no deference in the analysis), the Fifth Circuit has started down a path foreclosed by this Court in *Erie*, seeking to create a general federal law of property in the shadows of the Fifth Amendment.

This Court should grant the writ to confirm the deference a federal court should pay to a state's highest appellate court when deciding an issue of state law, particularly when the issue is antecedent to federal constitutional issues.

CONCLUSION

For the foregoing reasons a writ of certiorari should issue, the decision of the court of appeals below should be reversed and the decision of the District Court affirmed in all respects.

Respectfully submitted,

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April 4, 1997

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 95-50160

WASHINGTON LEGAL FOUNDATION;
WILLIAM R. SUMMERS; MICHAEL J. MAZZONE,
Plaintiffs-Appellants,

v.

TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION; W. FRANK NEWTON, Chairman, Texas Equal Access to Justice Foundation; THOMAS R. PHILLIPS, Chief Justice; RAUL GONZALEZ, Justice; JACK HIGHTOWER, Justice; NATHAN L. HECHT, Justice; LLOYD A. DOGGETT, Justice; BOB GAMMAGE, Justice; CRAIG T. ENOCH, Justice; JOHN CORNYN, Justice; ROSE SPECTOR, Justice; Supreme Court DFTS,
Defendants-Appellees.

Appeal from the United States District Court
for the Western District of Texas

Sept. 12, 1996

Before WISDOM, GARWOOD and JONES, Circuit Judges.

WISDOM, Circuit Judge:

The plaintiffs-appellants appeal the district court's denial of their motion for summary judgment and the

court's award of summary judgment to the defendants-appellees, in which the district court upheld the constitutionality of the Texas statute, Interest on Lawyers Trust Accounts Program (IOLTA), and found that the defendants are entitled to limited immunity under the Eleventh Amendment. For the reasons that follow, we REVERSE the judgment of the district court in part, VACATE and remand in part, and AFFIRM in part.

I.

Statement of Facts

Clients often give their attorneys money to be held in escrow, such as retainer fees or closing costs for a transaction. In Texas, traditional ethical rules require attorneys to place this money in a trust account that permits withdrawal on demand. The ethical rules also allow attorneys to aggregate all client funds into a single trust account and prohibit attorneys from commingling their own money with the trust fund. Because federal law prohibited banks from paying interest on demand accounts,[1] these accounts formerly amounted to interest-free loans to the banks.

In 1980, new banking regulations allowed negotiable order of withdrawal (NOW) accounts,[2] which operate as interest-bearing checking accounts. NOW accounts created a vehicle for attorneys to pool client funds into an interest-bearing trust account, provided that none of the funds belong to a for-profit corporation.[3] Attorneys, however, may not deduct the costs of maintaining the trust account from the interest earned, because such a practice would constitute an impermissible benefit from the management of the trust account in violation of the ethical rules.

[1] S.REP. No. 96-368, 9th Cong., 2d Sess. 5, *reprinted in* 1980 U.S.C.C.A.N. 240, 240.

[2] Depository Institutions Deregulation and Monetary Control Act of 1980, 94 Stat. 132, 146 (codified as amended at 12 U.S.C.A. § 1832 (West 1989)); *see also* S.REP. No. 96-368, *reprinted in* 1980 U.S.C.C.A.N. at 242-43.

[3] *See* 12 U.S.C.A. § 1832(a)(2) (permitting NOW acounts to consist of commingled funds belonging to numerous individuals or non-profit organizations or both).

The creation of NOW accounts led to the development of IOLTA programs. The IOLTA concept arises from the premise that there are still situations in which, because of the nominal amount of a client's funds to be held or the brief period for which a client's funds will be held, NOW accounts are not feasible; the costs of maintaining such accounts outweigh the interest that each client would have earned. In these situations, the trust accounts still operated as interest-free loans to the banks. IOLTA is an attempt to switch this benefit from the banks to legal providers for the indigent.

Under its statutory power to regulate the state bar, the Texas Supreme Court created its IOLTA program in 1984, which is modeled after IOLTA programs used in other states and which seeks to capitalize on this banking anomaly. The IOLTA program originally permitted attorneys to place client funds that were "nominal in amount" or were "reasonably anticipated to be held for a short period of time" into an unsegregated interest-bearing bank account (IOLTA account), the interest of which is paid to the Texas Equal Access to Justice Foundation (TEAJF), a non-profit corporation created by the Texas Supreme Court.[4] At that time, Texas's IOLTA program was voluntary, meaning that an attorney could choose whether to participate but clients had no choice, other than to select an attorney who did not maintaian an IOLTA account.

[4] *See* TEX.GOV'T CODE ANN. tit. 2, subtit. G, app. A, art. 11 §§ 6-7 (1987). Attorneys must make a reasonable determination as to whether a client's funds are nominal in amount or only to be held for a short period of time. When this determination is made in good faith, then an attorney cannot be liable for this decision. *Id.* § 7.

The TEAJF's purpose is to manage and distribute the interest earned from the IOLTA accounts to non-profit organizations that "have as a primary purpose the delivery of legal services to low income persons",[5] with the exception that no funds may be used to finance class action lawsuits or to lobby on behalf of a political candidate or issue.[6] Nearly all states have similar systems, which were designed to provide much-needed finances to legal providers for the impoverished. States have drastically slashed the budgets for such programs over the years; in 1993, the Texas legislature even refused to enact a modest increase in court filing fees to compensate for temporary IOLTA shortfalls.

Initially, the Texas IOLTA program did not meet expectations. Attorneys were reluctant to deposit their client funds into IOLTA accounts and impoverished Texas citizens still were unable to obtain legal assistance because of a lack of resources. Texas's voluntary IOLTA program yielded only $1 million per year. Following the lead of several other states and the recommendation of the American Bar Association, in 1988, the Texas Supreme Court made attorney participation in the IOLTA program mandatory, requiring that attorneys deposit client funds in IOLTA accounts under certain circumstances.[7] The revised rules, which became effective in 1989, state that

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[5] TEXAS RULES OF COURT—STATE, Rules Governing the Operation of the Texas Equal Access to Justice Program [TEAJF rule] rule 10 (West 1996).

[6] *Id.* rule 15. The TEAJF, however, may provide funds "to finance suits against governmental entities on behalf of individuals in order to secure entitlement to benefits", such as Social Security, Medicaid, and public housing. *Id.*

[7] Attorneys and law firms must open their own IOLTA accounts at a financial institution and direct the depository institution "to remit, at least quarterly, interest earned on the average daily balance in the account, less reasonable service charges" to the TEAJF. TEAJF rules 7, 9.

> [a]n attorney . . . receiving in the course of the practice of law . . . client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time, *shall* establish and maintain a separate interest-bearing demand account at a financial institution and *shall* deposit in the account all those client funds.[8]

The rules further guide an attorney's decision as to whether funds are suitable for deposit in an IOLTA account, stating that a client's funds may be deposited in an IOLTA account only if

> such funds, considered without regard to funds of other clients which may be held by the attorney . . . , could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client.[9]

Under the mandatory IOLTA program, Texas realized a dramatic increase in IOLTA revenue, with recent earnings of approximately $10 million per year. The TEAJF distributes these funds to various non-profit organizations who apply to the TEAJF for funding.

Procedural History

The plaintiffs' objections to the activities of some of the IOLTA fund recipients, such as those groups providing legal aid to refugees seeking political asylum in the United States and those organizations assisting death row

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[8] TEX. GOV'T CODE ANN. tit. 2, subtit. G, app. A, art. 11 § 5 (West Supp.1995) (emphasis added).

[9] TEAJF rule 6.

inmates to challenge their death sentences, prompted them to bring this suit.[10] The plaintiffs allege that the IOLTA program constitutes an impermissible taking of property, in violation of the Fifth Amendment of the United States Constitution, and that the program also forces them to support speech that they find offensive, in violation of the First Amendment. The plaintiffs request compensation for the interest proceeds that the Teaxs IOLTA program earned from their deposit and an injunction against the further application of the Texas IOLTA program.

The defendants [11] moved to dismiss the case for failure to state a claim. Though the district court denied this motion, it granted the defendants' subsequent motion for summary judgment and denied the plaintiffs' summary judgment motion. The district court, finding the logic of the First and Eleventh Circuits "compelling",[12] reasoned that there was no property interest at stake in the interest proceeds earned on funds deposited in IOLTA accounts.[13] Having made this determination,

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[10] The plaintiffs consist of Michael J. Mazzone, a Texas attorney who regularly places clients' funds into an IOLTA account and who asserts that practical problems prevent him from practicing law without collecting nominal or short-term client funds; William J. Summers, a Texas citizen who has funds currently held in an IOLTA account and who regularly uses Texas attorneys; and the Washington Legal Foundation, a public interest law firm whose members are similarly situated to Mazzone and Summers.

[11] In its suit, the plaintiffs named as defendants the TEAJF; W. Frank Newton, the director of the TEAJF; and all the Justices of the Texas Supreme Court.

[12] *Washington Legal Found. v. Texas Equal Access to Justice Found.*, 873 F.Supp. 1, 6-7 (W.D.Tex.1995) (citing *Washington Legal Found. v. Massachusetts Bar Found.*, 993 F.2d 962, 975-76 (1st Cir.1993) and *Cone v. State Bar of Fla.*, 819 F.2d 1002, 1004 (11th Cir.), *cert. denied*, 484 U.S. 917, 108 S.Ct. 268, 98 L.Ed.2d 225 (1987)).

[13] *Id.* at 7.

the district court then dismissed the plaintiffs' First and Fifth Amendment arguments.[14] The district court concluded by holding that the TEAJF is entitled to Eleventh Amendment immunity against all of the plaintiffs' claims and that Newton is subject only to the plaintiffs' claims of injunctive and prospective relief. The plaintiffs now appeal the district court's decision.

II.

It has been suggested that the IOLTA program represents a successful, modern-day attempt at alchemy.[15] While legends abound concerning the ancient, self-professed alchemists who worked tirelessly towards their goal of changing ordinary metal into precious gold, modern society generally scoffs at this attempt to create "something from nothing." The defendants in this case denounce such skepticism, declaring that they have unlocked the magic that eluded the alchemists. The alchemists failed because the necessary ingredients for their magic did not exist in historical times: the combination of attorney's client funds and anomalies in modern banking regulations. According to the defendants' theory, the interest proceeds generated by Texas's IOLTA accounts exist solely because of an anomaly in banking regulations and, until the creation of the IOLTA program, that interest belonged to no one. The defendants then contend that Texas used the IOLTA program to stake a legitimate claim to these funds and that the plaintiffs cannot now seek to repossess the fruits of this magic as their own. We, however, view the IOLTA interest proceeds not as the fruit of alchemy, but as the fruit of the clients' principal deposits.

State law defines "property" and the United States Constitution protects private property from government

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[14] *Id.* at 8, 10.

[15] AMERICAN BAR ASS'N. CIVIL JUSTICE: AN AGENDA FOR THE 1990's 56-72 (1989).

encroachment.[16] Texas observes the traditional rule that "interest follows principal", which recognizes that interest earned on a deposit of principal belongs to the owner of the principal.[17] In light of this rule, it seems obvious that the interest earned in the IOLTA accounts is the property of the clients whose money is held in those accounts; nevertheless, the district court adopted the theory espoused by the First and Eleventh Circuits, which circumvents this rule. The district court concluded that the plaintiffs cannot "have a [cognizable] property interest in interest proceeds that, but for the IOLTA Program, would have never been generated".[18] This reasoning, though, does not give proper weight to Supreme Court precedent.

In *Webb's Fabulous Pharmacies v. Beckwith*, the Supreme Court addressed a similar situation.[19] The case arose when the purchase of Webb's Fabulous Pharmacies faltered because, at the closing, the purchaser learned that Webb's had substantial debt that was not previously revealed. The purchaser then filed a complaint of interpleader in Florida state court and tendered the $1.8 million purchase price to the clerk of court. Florida law required the clerk to place the interpleaded funds into an interest-bearing account, to retain the interest earned for the court, and to deduct statutorily-defined fees for maintaining the funds. During the following year while the matter was being resolved, the interpleaded funds earned over $100,000 in interest. The court then appointed a receiver for Webb's, who promptly demanded that the

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[16] *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155, 161, 101 S.Ct. 446, 450-51, 66 L.Ed.2d 358 (1980) (citing *Board of Regents v. Roth*, 408 U.S. 564, 577, 92 S.Ct. 2701, 2709, 33 L.Ed.2d 548 (1972)).

[17] *E.g., Sellers v. Harris County*, 483 S.W.2d 242, 243 (Tex.1972).

[18] *Washington Legal Found.*, 873 F.Supp. at 7 (citing *Massachusetts Bar Found.*, 993 F.2d at 980; *Cone*, 819 F.2d at 1005-07).

[19] 449 U.S. 155, 101 S.Ct. 446, 66 L.Ed.2d 358 (1980).

clerk deliver the funds to him. The clerk surrendered the funds, but withheld approximately $10,000 for administrative fees and the $100,000 in interest that had accrued. The creditors then filed suit in state court to recover the interest. Ultimately, the Florida Supreme Court ruled against the creditors, holding that there was no unconstitutional taking because money deposited with the clerk was public money, interest earned on public money was not private property, and the statute only took that which it created.[20] This decision prompted the creditors to appeal to the United States Supreme Court.

The Supreme Court began by noting that the principal deposited with the clerk clearly constituted private property under Florida law.[21] The Court then determined that because the principal was "held only for the ultimate benefit of Webb's creditors, not for the benefit of the court" [22] and eventually would be distributed to them, state law gave the creditors a property interest proportional to their share of the principal.[23]

Having decided the ownership of the principal, the Court turned to the interest on the principal, "the fruit of the fund's use".[24] Reaching the opposite conclusion from that of the Florida Supreme Court,[25] the *Webb's* Court held that simply because the state ordered the placement of interpleaded funds into an interest-bearing ac-

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[20] *Beckwith v. Webb's Fabulous Pharmacies*, 374 So.2d 951, 952-53 (Fla.1979) (per curiam), *rev'd, Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155, 101 S.Ct. 446, 66 L.Ed.2d 358 (1980).

[21] *Webb's Fabulous Pharmacies*, 449 U.S. at 160, 101 S.Ct. at 450.

[22] *Id.* at 161, 101 S.Ct. at 451.

[23] *Id.*

[24] *Id.* at 162, 101 S.Ct. at 451.

[25] *Beckwith*, 374 So.2d at 953 (finding no unconstitutional taking because the IOLTA program only took the interest that it created).

count does not mean that the state can assert ownership of that interest.[26] Recognizing that "[t]he usual and general rule [under Florida law] is that any interest on an interpleaded and deposited funds follows the principal and is to be allocated to those who are ultimately to be the owners of that principal," the Court ruled that "earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property".[27] The Court then concluded that the Florida law perpetrated an unconstitutional taking of the interest, which is the property of the creditors who own the principal.[28]

After *Webb's*, numerous state courts debated the constitutionality of IOLTA programs. With the exception of the Indiana Supreme Court,[29] these courts agreed that *Webb's* was inapposite because of the difference in size between the deposit in *Webb's* and the funds eligible for deposit in IOLTA accounts.[30]

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[26] *Id.* at 162, 101 S.Ct. at 451.

[27] *Id.* at 162-63, 101 S.Ct. at 451-52.

[28] *Id.* at 163, 101 S.Ct. at 451-52.

[29] The Indiana Supreme Court refused to implement an IOLTA program, concluding that the program diverts clients' funds, because the interest proceeds belong to the clients, and convolutes attorneys' fiduciary duty to their clients. *In re Ind. State Bar Ass'ns Petition to Authorize a Program Governing Interest on Lawyers' Trust Accounts*, 550 N.E.2d 311, 312-15 (Ind.1990) (per curiam).

[30] *See In re Ark. Bar Ass'n Petition to Authorize a Program Governing Interest on Lawyer's Trust Accounts*, 283 Ark. 252, 675 S.W.2d 355, 357 (1984), *modified*, 289 Ark. 595, 709 S.W.2d 400 (1986); *Carroll v. State Bar of Cal.*, 166 Cal. App.3d 1193, 213 Cal.Rptr. 305, 312, *cert. denied*, 474 U.S. 848, 106 S.Ct. 142, 88 L.Ed.2d 118 (1985); *In re Interest on Trust Accounts*, 402 So.2d 389, 395-96 (Fla.1981); *Petition by the Mass. Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715, 718 (1985); *In re Petition of Minn. State Bar Ass'n*, 332 N.W.2d 151, 158 (Minn.1982); *Petition of N.H. Bar Ass'n*, 122 N.H. 971, 453 A.2d 1258, 1261 (1982); *In re Interest on Lawyers' Trust Accounts*, 672 P.2d 406, 408 (Utah 1983). While forty-nine states and the District of Columbia have adopted an IOLTA program in one form or another, *In re Indiana State Bar Ass'n*, 550 N.E.2d at 311, most states adopted the program without opinion or through legislation.

In 1987, the Eleventh Circuit considered the IOLTA issue in a suit challenging Florida's version of the IOLTA program.[31] The Eleventh Circuit distinguished *Webb's* on the basis that *Webb's* involved the ownership of over $100,000 in accrued interest, an amount that clearly exceeded any fees that were assessed.[32] In contrast, the Florida IOLTA program only concerned deposits that were so small or short-term that the administrative costs of maintaining an interest-bearing NOW account for that deposit would exceed any interest earned.[33] Relying on this factual distinction, the Eleventh Circuit concluded that Florida's IOLTA program does not commit an unconstitutional taking, reasoning that the owner of principal has no legitimate expectation of earning interest on money deposited into a Florida IOLTA account because "the use of [the client's] money had no net value, therefore there could be no property interest for the state to appropriate".[34] According to the Eleventh Circuit, the use of the money had no net value because the IOLTA program only takes the interest from those deposits that do not produce interest in excess of the administrative expenses incurred.[35]

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[31] *Cone*, 819 F.2d at 1002. The Florida IOLTA program was "voluntary", giving its attorneys the option of whether to participate. The clients, however had no choice, other than to choose an attorney who did not use the program. In *Cone*, the plaintiff paid her attorneys $100 to probate her husband's estate. The attorneys failed to return $13.75 of that amount to the plaintiff, which, during the following eleven years, earned $2.25 in interest. The plaintiff's attorneys paid that interest to Florida's IOLTA program and the plaintiff sued to recover that interest.

[32] *Id.* at 1007.

[33] *Id.* at 1006-07.

[34] *Id.* at 1007.

[35] *Id.* The First Circuit, in dicta, reached the same conclusion. *See Massachusetts Bar Found.*, 993 F.2d at 976. In that case, the

Although the Eleventh Circuit explicitly says otherwise,[36] inherent in its *Cone* analysis is the notion that the value of the alleged property involved determines whether there is a cognizable property interest. Under *Cone*, " 'property' is [erroneously] redefined as an interest that must necessarily benefit its owner".[37] The *Webb's* decision, however, creates a rule that is independent of the amount or value of interest at issue, holding that a property interest existed in the accrued interest simply because "[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property".[38] We see no reason why this rule does not apply to the instant case.

First Circuit stated that the plaintiffs did not assert property rights in the IOLTA interest proceeds, but sought only to protect the right to exclude the state from the use of their principal. *Id.* at 975-76. The right to exclude is one of the sticks in the bundle of property rights. *Id.* The Court, nevertheless, held that the interest earned on IOLTA accounts was not the plaintiff's property, *id.* at 976, an issue that was not properly before it. The First Circuit employed reasoning that parallels the decision in *Cone*, concluding that the IOLTA interest belongs to no one. *Id.* at 980.

[36] *Cone*, 819 F.2d at 1007 (stating that the decision does not establish "a de minimis standard for Fifth Amendment takings").

[37] Mary O. Sinibaldi, Note, *The Takings Issue in California's Legal Services Trust Account Program*, 12 HASTINGS CONST.L.Q. 463, 492 (1985).

[38] *Webb's Fabulous Pharmacies*, 449 U.S. at 164, 101 S.Ct. at 452. The *Webb's* Court concluded by holding that the Florida statute appropriated "the value of the use of the fund for the period in which it is held". *Id.; see also* Sinibaldi, *supra* note 37, at 493.

The *Cone* Court was correct to note that the value of the property involved does not effect the determination of whether a property interest exists; indeed, the Supreme Court rejected this position in *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 102 S.Ct. 3164, 73 L.Ed.2d 868 (1982), in which the Court held that "constitutional protection for the rights of private property cannot be made to depend on the size of the area permanently occupied". *Id.* at 436, 102 S.Ct. at 3176-77 (ruling that an ordinance requiring landlords to allow cable television providers to

The *Cone* court also failed to consider the precise events of the transaction, concluding that the only protectable property interest in interest proceeds attaches to the amount of interest that remains after a bank deducts its charges from the interest earned, because the owner of the principal only has a legitimate expectation of receiving those interest proceeds.[39] It appears, however, that a bank pays interest on the account and then deducts fees. It is a two-part process. As a result, a property interest attaches the moment that the interest accrues, from which the bank then deducts its charges from the depositor's account. Furthermore, the *Webb's* Court noted that Florida was under no obligation to place the interpleaded funds into an interest-bearing account, but once it did so, then any interest earned belongs to the depositor. The same rule applies to IOLTA accounts. Ethical rules historically demanded that attorneys hold their clients' funds in trust accounts, choosing the type of account in accordance with the best interests of the client.

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install small cable boxes on the roofs of their buildings was a permanent physical occupation, thereby entitling the landlords to compensation despite the small area appropriated and the fact that the installation actually enhanced the value of the buildings).

The defendants in the instant case suggest that *Loretto* does not govern IOLTA because money, unlike real property, is fungible and deductions from the IOLTA account are not physical appropriations of property. *Cf. United States v. Sperry Corp.*, 493 U.S. 52, 62 n. 9, 110 S.Ct. 387, 394-95 n. 9, 107 L.Ed.2d 290 (1989) (holding that the government did not perpetrate a taking when it deducted a statutory fee from the plaintiff's award by the Iran-United States Claims Tribunal instead of requiring the plaintiff to pay the fee separately). This argument is inappropriate because this suit does not concern the constitutionality of deductions for the maintenance of the IOLTA accounts, but rather addresses the ownership of the interest generated. *See id. Sperry* merely confirms that the state may charge fees to those who use its services, and may deduct those fees directly from any amount due to the user.

[39] *Cone*, 819 F.2d at 1007.

If attorneys still had this latitude, clients could not complain that a taking occurred when the attorney placed their funds in a non-interest bearing account, because until the interest accrues, the clients have no cognizable property right in the interest.[40] The Texas IOLTA program, however, requires attorneys to place certain client funds into an IOLTA account and then takes the interest that accrues for itself. In such a case, the plain rule is that the interest proceeds, once they have accrued, belong to the owner of the principal.

The defendants additionally argue that finding a property interest in the IOLTA interest overlooks the fact that, for practical banking reasons, the interest earned in trust accounts could never accrue to the clients. This argument ignores one of the critical driving forces of IOLTA: IOLTA programs became possible only with the announcement of Internal Revenue Service ruling 81-209.[41] In this ruling, the I.R.S. agreed that clients would not be taxed on the interest earned on their deposits in IOLTA accounts provided that they had no choice but to participate in the program.[42] By the terms of this ruling, if clients have any control over the interest generated from their nominal and short-term deposits into IOLTA accounts, then the interest generated is taxable income.[43]

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[40] *See Webb's Fabulous Pharmacies*, 449 U.S. at 161, 101 S.Ct. at 451 ("[A] mere unilateral expectation . . . is not a property interest entitled to protection.")

[41] Rev.Rul. 81-209, 1981-2 C.B. 16; *see also* Rev.Rul. 87-2, 1987-1 C.B. 18 (restating the decision announced in Rev.Rul. 81-209).

[42] Rev.Rul. 81-209, 1981-2 C.B. at 17 (justifying the tax-exempt status of IOLTA interest because under IOLTA plans, "no client may individually elect whether to participate in the program" and "bars clients from receiving the benefit of any interest earned").

[43] The I.R.S. was concerned about IOLTA programs providing a means to assign income and to avoid taxes on that income. By prohibiting clients from having any control over IOLTA funds, the I.R.S. is satisfied that the assignability problem is mooted.

To prevent this situation, Texas gave itself an IOLTA monopoly, reserving all the IOLTA interest proceeds for itself and requiring all of its attorneys to participate in the program. If private charities were to establish private IOLTA programs and clients could choose the program to which their funds went, then clients suddenly would have taxable income. Applying the defendants' arguments to such a scenario, the IOLTA funds would be too minimal to return to the clients, therefore falling outside of the *Cone* definition of property, yet clients still would have to pay income tax on the interest earned, interest which *Cone* would say was not their property. This situation flies in the face of reason.

We are also hesitant to declare that such interest is not property lest we incite a new gold rush, encouraging government agencies to dissect banking regulations to discover other anomalies that lead to "unclaimed" interest. One possible source is the interest earned by banks during the float time of checks. Consider a customer who deposits a check drawn on a payor bank with a depositary bank. "In a simple case, where the Federal Reserve Bank is the only intermediary, the depository bank will present that check to the Fed and receive a [provisional] credit in its reserve account."[44] The Fed then presents the check to the payor bank, whose account is debited and the payor bank must send notice of dishonor within the defined period or be liable for the amount.[45] Typically, this process takes one to two days, during which time the depositary bank has a provisional credit from the Federal Reserve in the amount of the check. Until recently, depositary banks were not required to pay interest to their customers during the time between the deposit of funds and the payor banks' deadline to send the notice

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[44] Robert D. Cooter & Edwin L. Rubin, *Orders and Incentives as Regulatory Methods: The Expedited Funds Availability Act of 1987*, 35 U.C.L.A.L.Rev. 1115, 1127 (1988).

[45] *See id.*

of dishonor, effectively giving the depositary banks an interest-free loan on the deposited funds during that time because the depositary banks could treat the provisional credit like cash reserves. This interest-free loan appears very similar to the one that the Texas Supreme Court sought to exploit with the IOLTA program and the interest earned on some checking accounts conceivably could fall below any benefits received, creating an IOLTA-like situation. While depositary banks now must pay interest on deposits from the time that they receive provisional credit from the Fed, credit unions are exempt from this requirement and still receive the benefit of these "interest-free loans".[46]

This is only one example of another "anomaly" in the banking industry and we cannot believe that such anomalies each create funds that belong to nobody. The traditional rule that interest follows principal must apply because that rule compensates the owners of the principal for the use of their funds. If a bank customer chooses, however, to allow the bank to profit in this manner, that decision does not give the state carte blanche to claim that property as its own. As technology continues to advance, the speed with which such transactions can occur will continue to increase, providing greater opportunities for states to try to collect the fractions of pennies that could be earned as interest during the float time of all these activities. Indeed, the faster the funds move, the more and more difficult it will be for individuals to make a practical claim to such funds. Nevertheless, the rule remains the same: any interest that accrues belongs to the owner of the principal, unless they agree otherwise.[47]

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[46] *See* 12 U.S.C.A. § 4005(a), (b) (West 1989).

[47] Furthermore, we also note that under the current IOLTA program, tax law seemingly defines property. If interest was no longer taxed, banks would not have to send 1099s, thereby greatly decreasing the administrative costs of IOLTA accounts. In this case, nearly all deposits would earn interest and clients clearly would be entitled to their funds. We find no basis to hinge property interests on the fickle tax code. Under the current scheme, any change in the costs to banks of managing small deposits would impact the determination of whether a property right in IOLTA interest exists. *See* Kenneth P. Kreider, Note, *Florida's IOLTA Program Does Not "Take" Client Property for Public Use*, 57 U.CIN.L.REV. 369, 391-93 (1988). This short-sighted view of property renders it unacceptable.

III.

The district court's decision on the merits is wholly premised on the notion that clients do not have a valid property interest in the interest proceeds on funds in IOLTA accounts. Having rejected this premise, we vacate the district court's award of summary judgment to the defendants and denial of summary judgment to the plaintiffs. We remand this case for reconsideration in the light of the principles explained in this decision and for further factual development of the record, such as the clarification of the types of account pooling permitted by the TEAJF rules.

With respect to the merits of the plaintiffs' claims, we note that to prevail on their taking claim, the plaintiffs must demonstrate that the taking was against the will of the property owner.[48] That or a similar showing would also likely be necessary to prevail on their First Amendment claim. We express no opinion as to whether such a showing has been, or can be, made in the context of this case. We leave these and such other issues as may surface to be addressed in the first instance by the district court on remand.

IV.

Finally, the district court also granted the defendants' request for immunity under the Eleventh Amendment with respect to the plaintiffs' claim for monetary restitution.

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[48] *See Yee v. City of Escondido*, 503 U.S. 519, 527, 12 S.Ct. 1522, 1528, 118 L.Ed.2d 153 (1992).

The parties now only dispute whether the district court erred by declaring the defendants immune to the plaintiffs' restitution claim. The parties do not seriously challenge this portion of the district court's ruling; the defendants concede that they are subject to the plaintiffs' prospective injunction claims and the plaintiffs admit that their "principal concern all along has been in obtaining prospective injunctive relief." We suggest another reason for the parties' lackadaisical approach to this part of the decision: they realize that the district court is correct.

The Eleventh Amendment shields states and their agencies from suits in federal court without the states' consent.[49] Initially, we note that the Texas Supreme Court is entitled to Eleventh Amendment immunity.[50] This immunity extends to the TEAJF becase the Texas Supreme Court created the TEAJF pursuant to its rule-making authority and the TEAJF acts on behalf of the Texas Supreme Court to carry out its role, which the Texas Supreme Court defined.[51] Similarly, defendant Newton is entitled to immunity because he is being sued in his official capacity as chairman of the TEAJF, and therefore is also a state actor. The immunity that applies, as held by the district court, is limited and protects the defendants only from the plaintiffs' claims for reimbursement because the Eleventh Amendment does not protect the state from federal suits seeking injunctive relief.[52]

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[49] *Word of Faith World Outreach Ctr. Church v. Morales*, 986 F.2d 962, 965 (5th Cir.), *cert. denied*, 510 U.S. 823, 114 S.Ct. 82, 126 L.Ed.2d 50 (1993).

[50] *See Lewis v. Louisiana State Bar Ass'n*, 792 F.2d 493, 497 (5th Cir.1986).

[51] *See id.* at 497 & n. 4.

[52] *Word of Faith*, 986 F.2d at 965 (5th Cir.); *see also Lewis*, 792 F.2d at 497. The parties also disagree over whether the plaintiffs are entitled to monetary relief under their 42 U.S.C. § 1983 claim for monetary damages. Because neither a state nor state officials sued in their official capacity are "persons" within the meaning of § 1983 when the relief sought is monetary, the plaintiffs cannot recover their claim for reimbursement from the defendants. *See Will v. Michigan Dep't of State Police*, 491 U.S. 58, 69-71 & n. 10, 109 S.Ct. 2304, 2311-12 & n. 10, 105 L.Ed.2d 45 (1989).

Accordingly, we hold that the district court did not err on this issue.

V.

For the foregoing reasons, we find that the district court erred by holding that the clients do not have a cognizable property interest in the interest proceeds that are earned on their deposit in IOLTA accounts. We VACATE the district court's award of summary judgment for the defendants and denial of summary judgment for the plaintiffs and REMAND for further consideration. Finally, we AFFIRM the limited immunity that the district court granted to the defendants.

APPENDIX B

UNITED STATES DISTRICT COURT
W.D. TEXAS
AUSTIN DIVISION

Civ. No. A-94-CA-081 JN

WASHINGTON LEGAL FOUNDATION,
MICHAEL J. MAZZONE, and WILLIAM R. SUMMERS

v.

TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION, W. FRANK NEWTON, THOMAS R. PHILLIPS, RAUL A. GONZALEZ, JACK HIGHTOWER, NATHAN L. HECHT, LLOYD DOGGETT, JOHN CORNYN, BOB GAMMAGE, CRAIG T. ENOCH and ROSE SPECTOR

Jan. 19, 1995

MEMORANDUM ORDER AND JUDGMENT

NOWLIN, District Judge.

Before the Court are the Motion for Summary Judgment filed by Defendant Texas Equal Access to Justice Foundation's ("TEAJF") and Defendant W. Frank Newton, its chair, the Motion for Summary Judgment filed by Defendants Thomas Phillips, Raul Gonzalez, Jack Hightower, Nathan Hecht, Lloyd Doggett, John Cornyn, Bob Gammage, Craig Enoch, and Rose Spector ("the Supreme Court Defendants"),[1] and the Motion for Summary Judgment filed by the Plaintiffs, Washington Legal Foundation, William R. Summers, and Michael J. Mazzone. Also before the Court are the Responses addressing these motions, and the Replies addressing these Responses. Having considered these pleadings, the evidence submitted by the parties, the arguments of counsel, and the relevant law, the Court enters the following decision.

[1] The Supreme Court Defendants' Motion for Summary Judgment simply adopts the positions taken by the TEAJF in its Motion for Summary Judgment.

NATURE OF THE CASE

The Plaintiffs in this action are the Washington Legal Foundation, a self-described non-profit public interest law and policy center, Michael Mazzone, a Texas resident and attorney licensed to practice by the Texas Bar, and William Summers, a Texas resident and consumer of legal services rendered by members of the Texas Bar. The Plaintiffs have filed this action pursuant to 42 U.S.C. § 1983, claiming that the Texas Interest on Lawyers' Trust Accounts ("IOLTA") Program, which is implemented and overseen by the Texas Equal Access to Justice Foundation ("TEAJF"), violates their rights under the First and Fifth Amendments of the United States Constitution. In addition to a declaratory judgment finding the IOLTA Program unconstitutional, the Plaintiffs seek injunctive relief prohibiting mandatory participation in the IOLTA Program, a return of the full amount of interest earned on Plaintiffs' money placed in IOLTA trust accounts, and an award of costs and attorneys' fees.

The Defendants have responded that the IOLTA Program neither effects a taking of the interest generated by the Program in violation of the Fifth Amendment, nor compels speech or involuntary association in violation of the First Amendment. The Defendants alternately contend that the IOLTA Program serves a significant state interest through means narrowly tailored to serve that interest, and, accordingly, there is no First Amendment violation. Finally, the Defendants contend that they are entitled to Eleventh Amendment immunity and that the

TEAJF Defendants are not "persons" subject to suit under 42 U.S.C. § 1983.

SUMMARY JUDGMENT STANDARD

Summary judgment is appropriate if the record discloses "that there is no genuine issue of material fact, and the movant is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). To determine whether there are genuine fact issues, the court must first consult the applicable law to ascertain what issues are material. *Lavespere v. Niagara Machine & Tool Works*, 910 F.2d 167, 178 (5th Cir.1990), *cert. denied*, —— U.S. ——, 114 S.Ct. 171, 126 L.Ed.2d 131 (1993), *abrogated on other grounds, Little v. Liquid Air Corp.*, 37 F.3d 1069 (5th Cir.1994). Next, the court must review the evidence on those issues, viewing the facts and inferences in the light most favorable to the nonmoving party. *Id.*

A party seeking summary judgment bears the initial burden of identifying those portions of the pleadings and discovery on file, together with any affidavits, which it believes demonstrate the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325, 106 S.Ct. 2548, 2554, 91 L.Ed.2d 265 (1986). Once the movant carries its burden, the burden shifts to the nonmovant to show that summary judgment should not be granted. *Id.* at 324-25, 106 S.Ct. at 2553-54. While the Court must review the facts drawing all inferences most favorable to the party opposing the motion, *Reid v. State Farm Mut. Auto. Ins. Co.*, 784 F.2d 577, 578 (5th Cir.1986), that party may not rest upon mere allegations or denials in its pleadings, but must set forth specific facts showing the existence of a genuine issue for trial. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256-57, 106 S.Ct. 2505, 2514, 91 L.Ed.2d 202 (1986). Factual controversies are resolved in favor of the nonmoving party, but only when there is an actual controversy, that is, when both parties have submitted evidence

of contradictory facts. *Little*, 37 F.3d at 1075. However, the court does not, in the absence of any proof, assume the nonmoving party could or would prove the necessary facts. *Id.*

FACTUAL BACKGROUND

For the most part, the Parties concede that there is no dispute as to any material fact underlying this cause of action. The material facts relating to the operation of the Texas IOLTA Program are set out below.

Article XI of the Rules of the State Bar of Texas establishes the Texas Equal Access to Justice Program (hereinafter "the IOLTA Program"). Under this program, an attorney receiving client funds that are "nominal in amount" or "reasonably anticipated to be held for a short period of time" is required to place the funds in an unsegregated interest-bearing bank account. *See* State Bar Rules Governing Operation of Equal Access to Justice Program Rule 6. More specifically, the only funds eligible for the IOLTA Program are those which

> could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client. *Id.*

Under the IOLTA rules, when a client tenders a nominal amount of funds, or funds that will be held for only a short term, the lawyer is obligated to first make an initial determination, using his or her good faith judgment, of whether such funds can be deposited into an account that could reasonably be expected to earn an amount of interest sufficient to offset the cost of establishing and maintaining the account. *Id.* For purposes of the Plaintiffs' claims, it is important to stress that the only funds eligible for deposit in an IOLTA account are those

that have no reasonable possibility of legally generating net interest income benefiting the client. Nothing prohibits an attorney from placing funds into a non-IOLTA account, if such funds are capable of generating net interest income to the client.[2]

Interest generated by these IOLTA accounts is to be paid to the Texas Equal Access to Justice Foundation, a non-profit corporation. *Id.*, Rule 9. The Foundation is charged with administering these funds, awarding them as grants to non-profit organizations that have a primary purpose of delivering legal services to low income persons. *Id.* Rules 10-12.[3] As evidenced by the TEAJF's annual reports, the beneficiary organizations provide a wide range of legal services, ranging from providing legal assistance to permanent resident aliens seeking naturalization, to documentation for Central American refugees seeking

[2] The Plaintiffs contend that there is a genuine issue of material fact regarding whether the Texas IOLTA program permits Texas attorneys to employ the banking practice of sub-accounting as a means of generating net interest on deposited funds, and whether sub-accounting is a practical means of generating net interest for clients who deposit small amounts of money with their attorney. The Court finds that this issue of fact is not material and therefore does not preclude summary judgment. As conceded by the Defendants, any type of account that can earn interest beyond the costs of maintaining such account is beyond the scope of IOLTA's coverage. In other words, if sub-accounting or some other creative (but legal) banking practice or service permits nominal funds to earn net interest, the IOLTA Program and the Texas Bar do not prohibit Texas lawyers from making use of them, even if the result is the placement of these nominal funds in non-IOLTA accounts.

[3] The professed goals of the IOLTA Program—meeting the unmet legal needs of indigent Texans—is indeed laudable. However the Court is conscious of Justice Holmes' warning that "(a) strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 416, 43 S.Ct. 158, 160, 67 L.Ed. 322 (1922).

asylum, to legal services to death row inmates, to various AIDS organizations.[4]

Originally, the Texas IOLTA Program was voluntary. However, with only voluntary participation by Texas lawyers, the Program generated insufficient funds to meet the legal needs of indigent Texans. Consequently, in 1988, the Texas Supreme Court entered an order amending the State Bar Rules and converting the voluntary IOLTA program into the mandatory program presently in operation.[5]

FIFTH AMENDMENT CLAIMS

The Plaintiffs allege that the IOLTA Program violates their Fifth Amendment rights by taking their property without just compensation. More specifically, the Plaintiffs allege both 1) that the Program effects a taking of the interest generated by the funds deposited into pooled

[4] One of the Plaintiffs' principal objections to the IOLTA Program is that some of the recipient organizations advocate positions to which the Plaintiffs are politically or ideologically opposed, such as expanding the rights of undocumented aliens or broadening the scope of anti-discrimination causes of action. In this regard, it bears noting that the IOLTA Rules prohibit the granting of funds to finance class actions, lawsuits against government entities (except to secure entitlements), or lobbying. *See* IOLTA Rule 15. However, the TEAJF apparently exercises little if any control or administrative influence over the out-of-court self-promotions and solicitations of some vocal attorneys or representatives of the donee entities.

[5] The need for the provision of legal services to low income persons, and possibly for a mandatory *pro bono publico* program for lawyers, have been prominent issues recently facing both the Texas Bar and the Texas Supreme Court. *See, e.g., State Bar of Texas, et al. v. Maria Gomez, et al.*, 891 S.W.2d 243 (Tex.1994). The Court surmises that the well-documented failures of the Texas Bar to meet the legal needs of needy Texans through voluntary activities, as well as the clamor for mandatory *pro bono* by some sectors of the Texas Bar have played a significant role in the implementation of the mandatory IOLTA Program presently under consideration.

IOLTA accounts, and 2) that the Program effects a taking of the "beneficial use" of their property by compelling them to deposit their funds in IOLTA accounts to generate income to support the Program.

The Fifth Amendment provides that private property shall not be taken for public use without just compensation. U.S. Const. amend. V.[6] For there to be a "taking" within the purview of the Fifth Amendment, the government must interfere "with interests that (are) sufficiently bound up with the reasonable expectations" of the plaintiff asserting the deprivation. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 125, 98 S.Ct. 2646, 2659, 57 L.Ed.2d 631 (1978); *see also Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. at 161, 101 S.Ct. at 450 ("[A] mere unilateral expectation or an abstract need is not a property entitled to protection."). In other words, the Plaintiffs must be able to assert a cognizable property interest to raise a Fifth Amendment takings claim. *Ruckelshaus v. Monsanto*, 467 U.S. 986, 1001, 104 S.Ct. 2862, 2871, 81 L.Ed.2d 815 (1984). Whether such an interest exists is a question of state law. *See, e.g., Webb's*, 449 U.S. at 161, 101 S.Ct. at 450 ("[P]roperty interests . . . are not created by the Constitution. Rather they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law . . . ."") (quoting *Board of Regents v. Roth*, 408 U.S. 564, 577, 92 S.Ct. 2701, 2709, 33 L.Ed. 2d 548 (1972)).

Ownership of IOLTA-Derived Interest

Whether the Plaintiffs' can prevail on their Fifth Amndment claim depends in large part upon the characterization and ownership of the interest generated by

[6] This prohibition is made applicable to the states by the Fourteenth Amendment. *Webb's Fabulous Pharmacy, Inc. v. Beckwith*, 449 U.S. 155, 160, 101 S.Ct. 446, 450, 66 L.Ed.2d 358 (1980).

the funds deposited in the IOLTA accounts—that is, whether they have a cognizable property interest in the IOLTA account interest. There is, of course, no dispute that the nominal funds given by Plaintiff Summers (the client) to Plaintiff Mazzone (his attorney), and which are deposited in Mazzone's IOLTA account, are at all times the property of Summers. The critical issue is to whom the proceeds (i.e., the interest earned) from such funds belong.[7]

The Plaintiffs contend that the client posesses property rights in the interest derived from IOLTA accounts. In support of this proposition, the Plaintiffs rely primarily upon the Supreme Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 101 S.Ct. 446, 66 L.Ed.2d 358 (1980). *Webb's* involved a challenge to Florida statute which permitted a county to take as its own the interest accruing on an interpleader fund deposited in the registry of a county court. The interpleaded funds involved in *Webb's* generated interest in excess of $100,000.00. The Supreme Court struck down the statute, holding that the earnings of interpleaded funds are incidents of ownership of the funds itself and are property in the Fifth Amendment context just as the interpleaded fund itself is property. *Webb's*, 449 U.S. at 160-65, 101 S.Ct. at 450-52. The rationale for the *Webb's* decision was based upon the "usual and general rule (that) any interest on an interpleaded and deposited fund follows the principal and is to be allocated to those who are ultimately to be the owners of that principal." 449 U.S. at 162, 101 S.Ct. at 451. On the basis of this holding, the Plaintiffs claim that they have a property interest in the interest earned on their nominal or short-term IOLTA funds.[8]

[7] For purposes of this inquiry, it must at all times be kept in mind that, under the IOLTA Rules, the principal amounts at issue cannot be reasonably expected to earn net interest on their own.

[8] The Plaintiffs point out that the Supreme Court cited as an example of this "usual and general rule" *Sellers v. Harris County*,

The principles enunciated in *Webb's* have been frequently invoked in challenges to IOLTA programs operating in other jurisdictions. Such invocations have been almost uniformly without success.[9]

In *Cone v. State Bar of Florida*, 819 F.2d 1002, 1004 (11th Cir.), *cert. denied* 484 U.S. 917, 108 S.Ct. 268, 98 L.Ed.2d 225 (1987), the Eleventh Circuit evaluated the applicability of the holding in *Webb's* to a Fifth Amendment challenge to the Florida Bar's Interest on Trust Accounts ("IOLTA") program.[10] The Eleventh

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483 S.W.2d 242 (Tex.1972) a decision of the Texas Supreme Court involving essentially the same operative facts as *Webb's*. In *Sellers*, the Texas Supreme Court ruled that the interest generated from $1,000,000 in insurance policy proceeds that were interpleaded into a county court's registry belonged to the owner of the principal and not the county, which claimed it was entitled to the interest pursuant to state statute. These proceeds generated interest in excess of $6,000.00 per month. *Sellers*, 483 S.W.2d at 242.

[9] The supreme courts of all fifty states have examined the constitutionality, efficacy, and propriety of IOLTA programs. Forty-nine of these state courts have approved them in one form or another. The lone exception is the Indiana Supreme Court, which declined to adopt the state bar's proposed IOLTA program in a nonadversarial proceeding. *See In re Indiana State Bar Association's Petition to Authorize a Program Governing Interest on Lawyer's Trust Accounts*, 550 N.E.2d 311 (Ind.190). However, contrary to the Plaintiffs' characterization of this opinion, the Indiana Supreme Court's refusal to adopt an IOLTA program was *not* predicated on constitutional grounds, but rather solely upon the court's view that the proposed IOLTA program was contrary to its interpretation of the ethical obligations of Indiana attorneys. *See id.* at 315 ("[L]et there be no question that the IOLTA program currently promoted by the Indiana Bar Association violates our Rules for the Discipline of Attorney and Rules of Professional Conduct."). This Court declines to consider the ethical implications of the Texas IOLTA Program as such questions are more properly raised before the entity charged with regulating the conduct of members of the Texas Bar—namely, the Texas Supreme Court. *See* TEX.GOV.CODE ANN. § 81.011(c) (Vernon 1988).

[10] The Florida Bar's Interest On Trust Accounts program is similar in both purpose and operation to the Texas IOLTA program. *See Cone*, 819 F.2d at 1003.

Circuit found that, despite "superficial similarities," the *Webb's* decision had no application in the IOLTA context, due to the fact that the use of funds in an IOLTA account had no net value. *Cone*, 819 F.2d at 1007. As the circumstances surrounding the funds and related banking practices could not lead to a legitimate expectation of interest exclusive of administrative costs and expenses, there could be no property interest for the state to appropriate via the collection of interest earned on pooled IOTA funds. *Id.* The court stated that there was no taking of property because, standing alone, the plaintiff's funds deposited in her attorney's IOTA (IOTA) account could not earn anything, and consequently, there could be no legitimate claim of entitlement. *Id.*

The holding and reasoning in *Cone* was cited with approval by the First Circuit in *Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962, 975-76 (1st Cir.1993), a case involving another unsuccessful challenge to the Massachusetts Bar's IOLTA Program. The court also noted some "superficial similarities" between *Webb's* and the challenge to Massachusetts IOLTA program, but stressed a fundamental difference—namely, that the claimants in *Webb's* had property rights in the accrued net interest generated by the deposited funds, while in the IOLTA context, the property interests are essentially intangible. *Id.* In accordance with the decision in *Cone*, the First Circuit held that the Plaintiffs' claimed property rights in both the interest generated by their funds and the beneficial use of the funds deposited in IOLTA accounts were insufficient to support a Fifth Amendment claim.

The logic supporting both of these opinions is compelling. By definition, the only funds eligible for deposit in an IOLTA account are those which are incapable of earning net interest if deposited by themselves in an individual (non-pooled) account. Further, as stated above, for there to be a "taking" within the purview of the Fifth Amendment, the state action must interfere with interests

that are sufficiently bound up with the reasonable expectations of the person asserting the deprivation. This "reasonable expectation" of a property interest is foreclosed by the very wording and operation of the rules governing the IOLTA program—that is, if there is any reasonable expectation of realizing net interest on a sum, the sum is exempted from IOLTA coverage. Simply put, the Court cannot conclude that the Plaintiff's have a property interest in interest proceeds that, but for the IOLTA Program, would never have been generated. Without such a property interest, the Plaintiffs are unable to state a viable Fifth Amendment claim pertaining to their ownership of the interest generated by funds placed in IOLTA accounts.

The Court finds that in the case of the Texas IOLTA Program (as in the case of the Florida and Massachusetts program), it is only through combining small or short-term deposits that there is a possibility of creating interest. Put another way: such interest has been generated only by virtue of "an anomaly created by the practicalities of accounting, banking practices, and the ethical obligations of lawyers." *Washington Legal Foundation*, 993 F.2d at 980. It follows then that such interest income is not within the legitimate expectations of the owner of any one of the principal amounts. Accordingly, such amounts cannot be deemed to be appropriated by the IOLTA program.[11] In sum, the property rights of the Plaintiffs in this action and the claimants in *Webb's* are clearly different, and as there is no property interest or expectation appropriated, there is no taking for Fifth Amendment purposes. Accordingly, the Court finds that the Plaintiffs have failed to allege a cognizable Fifth Amendment takings claim with regard to the interest generated by funds placed in IOLTA accounts.

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[11] *See Cone*, 819 F.2d at 1007: "IOLTA programs do not amount to a taking because they create interest which was not within the reasonable expectations of any one of the principal amounts."

The Plaintiffs cite two additional cases involving prison inmates as authority for the proposition that the client has a protectable property interest in the proceeds generated from funds deposited into an IOLTA account. In *Tellis v. Godinez*, 5 F.3d 1314 (9th Cir. 1993), *cert. denied* —— U.S. ——, 115 S.Ct. 354, 130 L.Ed.2d 309 (1994) a prisoner brought suit against prison officials alleging that they violated his due process rights by withholding interest earned on funds in his personal bank account. The Ninth Circuit recognized that the prisoner did indeed have a property right in the interest generated by his funds. However, the Ninth Circuit's holding must be read in the context of the relevant statute upon which the prisoner's claim was based. This statute provided that the interest and income earned on the money in the prisoner's trust fund must be credited to that fund *after* applicable charges were deducted. *Tellis*, 5 F.3d at 1316 (quoting Nev.Rev.Stat. § 209.241). Contrary to the Plaintiffs' argument, *Tellis* simply cannot be read as supporting the broader conclusion that a person has a protected property interest in interest generated from his or her funds, regardless of whether any net interest can ever be realized.

The Plaintiffs also cite the Fifth Circuit's opinion in *Eubanks v. McCotter*, 802 F.2d 790 (5th Cir.1986), another case in which prisoners sued prison officials alleging that their failure to pay the prisoners the interest generated by pooled inmate trust funds constituted a taking. The Fifth Circuit reversed the lower court, which had dismissed *sua sponte* the claim as frivolous. The Fifth Circuit found that the prisoners' claims were "not wholly insubstantial or frivolous" and were "minimally sufficient to require a decision on the merits." *Eubanks*, 802 F.2d at 793-94. This, however, is the limit of the extent to which the Fifth Circuit recognized or endorsed the viability of these claims. *See Id.* at 794. Thus, *Eubanks* applicability to the Plaintiffs' position is tenuous at best.

In scrutinizing the holdings and the underlying facts of both *Tellis* and *Eubanks*, it may be concluded that the prisoners were recognized to have property interests in the interest generated by their inmate trust accounts, but only after applicable charges were deducted. Accordingly, the Court finds that these cases, like *Webb's* and *Sellers* are inapposite.

Fifth Amendment Protection of Plaintiffs' Expectation Interest

The Plaintiffs alternately argue that, even if they lack a protected property interest in the generated interest, they have a protected property right to exclude others from the beneficial use of their funds while they are deposited in IOLTA accounts. In support of this purported right, the Plaintiffs rely primarily upon cases standing for the proposition that property owners may exclude others from their real, or tangible property. *See, e.g., Dolan v. City of Tigard*, —— U.S. ——, 114 S.Ct. 2309, 129 L.Ed.2d 304 (1994) (government requirement that property owner dedicate portion of property within flood plain for public improvements contrary to Fifth Amendment); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 102 S.Ct. 3164, 73 L.Ed.2d 868 (1982) (government regulation requiring private property owners to allow conduits for cable television to be attached even when property owners were not cable subscribers was an unconstitutional taking without just compensation); *Kaiser Aetna v. United States*, 444 U.S. 164, 100 S.Ct. 383, 62 L.Ed.2d 332 (1979) (federal government's imposition of a navigational servitude on owners of a private marina requiring that they allow a right of access to the public amounted to an unconstitutional taking). But, as noted, these cases all involve governmental intrusions or interference with real or tangible property. These cases do not recognize a similarly protected property right to control or exclude others from intangible property, and therefore are insufficient to support a finding

that the Plaintiffs have a protectable property interest in the beneficial use of IOLTA-eligible funds.[12]

The Plaintiffs do correctly note that there are certain "intangible rights" that merit Fifth Amendment protection. *See, e.g., Lynch v. United States* 292 U.S. 571, 54 S.Ct. 840, 78 L.Ed. 1434 (1934) (valid contracts are property which cannot be taken without just compensation); *James v. Campbell*, 104 U.S. 356, 26 L.Ed. 786 (1881) (patents entitled to Fifth Amendment protection). However, inherent in these types of property is the necessity of excluding others to preserve the property interest. Accordingly, these cases fail to support the Plaintiffs' proffered analogy. *See Washington Legal Foundation*, 993 F.2d at 974 n. 10 ("[W]e do not finds analogous, intangible property rights which, by their nature or by agreement, require the exclusion of others to preserve the property interest).

To preclude summary judgment on the Plaintiffs' Fifth Amendment claims, the Court would have to find a genuine issue of material fact as to the operation of the IOLTA Program, the nature of the Plaintiffs property interest in interest generated by funds placed in IOLTA accounts, or the effect of the IOLTA Program on the generated interest. The Court finds that there is no factual dispute as to these issues, but only as to the characterizations of the client's property interests, all questions of law. Having resolved these questions in favor of the Defendants, the Court finds that the Plaintiffs' Fifth Amendment claims should be dismissed.[13]

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[12] *See Washington Legal Foundation*, 993 F.2d at 974.

[13] The conclusion that the Texas IOLTA Program does not violate the Fifth Amendment is consistent with the holdings of numerous other decisions from other jurisdictions. *See, e.g., Cone, supra; Washington Legal Foundation, supra; In re Interest on Trust Accounts*, 402 So.2d 389 (Fla.1981); *Petition of Minnesota State Bar Association*, 332 N.W.2d 151 (Minn.1982); *Petition of New Hampshire Bar Association*, 122 N.H. 971, 453 A.2d 1258 (1982);

PLAINTIFFS' FIRST AMENDMENT CLAIMS

The Plaintiffs further claim that the collection and use of interest generated from funds clients place with their attorneys under the Texas IOLTA Program deprive the clients of their rights of freedom of speech and association guaranteed by the First Amendment.[14]

"It is well-established that the freedom of speech protected by the First Amendment includes the freedom to choose 'both what to say and what *not* to say.'" *Hays County Guardian v. Supple*, 969 F.2d 111, 123 (5th Cir. 1992), *cert. denied* —— U.S. ——, 113 S.Ct. 1067, 122 L.Ed.2d 371 (1993) (quoting *Riley v. National Federation for the Blind*, 487 U.S. 781, 797, 108 S.Ct. 2667, 2677, 101 L.Ed.2d 669 (1988)) (emphasis in original). The right to refrain from speech is violated when the government compels an individual to endorse a belief that he or she finds repugnant. *Id.* (citations omitted). It also may be violated when the government compels an individual to subsidize political and ideological purposes with which he or she disagrees. *Id.* (citing *Lyng v. Int'l Union, United Auto Workers*, 485 U.S. 360, 369, 108 S.Ct. 1184, 1191, 99 L.Ed.2d 380 (1988)); *Chicago Teachers Union Local No. 1 v. Hudson*, 475 U.S. 292, 301, 106

In re Interest on Lawyers Trust Accounts, 672 P.2d 406 (Utah 1983); *In re Interest on Lawyers Trust Accounts* 283 Ark. 252, 675 S.W.2d 355 (1984); *Petition of Massachusetts Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715 (1985); *Carroll v. State Bar of California*, 166 Cal.App.3d 1193, 213 Cal.Rptr. 305 (4th Dist.), *cert. denied sub nom. Chapman v. State Bar of California*, 474 U.S. 848, 106 S.Ct. 142, 88 L.Ed.2d 118 (1985).

[14] The First Amendment provides: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people to peaceably assemble, and to petition the Government for a redress of grievances." U.S. Const. amend. I. The Fourteenth Amendment makes this limitation applicable to the States and to its subdivisions. *See Gitlow v. New York*, 268 U.S. 652, 45 S.Ct. 625, 69 L.Ed. 1138 (1925) and *Lovell v. Griffin*, 303 U.S. 444, 58 S.Ct. 666, 82 L.Ed. 949 (1938).

S.Ct. 1066, 1073, 89 L.Ed.2d 232 (1986); *Abood v. Detroit Bd. of Educ.*, 431 U.S. 209, 234-35, 97 S.Ct. 1782, 1799, 52 L.Ed.2d 261 (1977).

Essentially, the Plaintiffs claim that their mandatory participation in the IOLTA Program forces clients to financially support, and thereby associate with, various recipient organizations whose purported objectives the Plaintiffs find objectionable.[15] However, at least as far as the client is concerned, such a claim is necessarily predicated upon the Plaintiffs' claim that the funds generated from the IOLTA accounts are, in fact, the property of the client. As determined in the preceding discussion regarding the Plaintiffs Fifth Amendment claims, the interest generated by the IOLTA program is not the property of any of the Plaintiffs, thus, the collection and use of the interest by the IOLTA program does not constitute financial support by the Plaintiffs of the recipient organizations.

Furthermore, the IOLTA Program in no way compels any of the Plaintiffs to actually associate or otherwise be linked with the recipient organizations that they find repugnant (e.g., by becoming members or being publicly listed as benefactors). Because the Plaintiffs have failed to adequately allege any connection between themselves and the IOLTA recipient organizations, the Court finds that the Texas IOLTA Program does not unconstitu-

[15] As noted *supra*, IOLTA Rules prohibit recipient organizations from using grants to fund lobbying or certain types of litigation. These limitations do not lead the Court to conclude that First Amendment issues have not been raised, despite the Defendants' contentions. Admittedly the collection and disbursement of funds appears to lack a First Amendment dimension. However, it is not disputed that the funds collected through IOLTA are awarded to meet the otherwise unmet needs for legal service of indigent Texans. The Supreme Court has recognized the expressive nature of litigation within the context of the First Amendment. *See Lehnert v. Ferris Faculty Ass'n*, 500 U.S. 507, 111 S.Ct. 1950, 114 L.Ed.2d 572 (1991). Accordingly, the Court finds that there is expressive activity sufficent to invoke the First Amendment.

tionally burden the Plaintiffs' First Amendment rights. *See Washington Legal Foundation*, 993 F.2d at 980. *Compare Carroll v. Blinken*, 957 F.2d 991 (2d Cir.), *cert. denied*, —— U.S. ——, 113 S.Ct. 300, 121 L.Ed.2d 224 (1992) (compulsory student fees used to support statewide student advocacy organization, which automatically made all students members, impermissibly forced association in violation of the First Amendment).

The Plaintiffs also appear to contend that, even absent any financial link to the IOLTA Program, the mandatory Program forces attorneys to be associated with the TEAJF and its recipient organizations. It arguably could be said that the mandatory IOLTA Program forces attorneys to associate with these groups (albeit in an attenuated fashion). However, even if this were true, such compelled association does not give rise to a constitutional violation. In *Keller v. State Bar of California*, 496 U.S. 1, 110 S.Ct. 2228, 110 L.Ed.2d 1 (1990), the Supreme Court considered a challenge brought by California attorneys regarding the use of the state bar's dues to finance certain ideological or political activities. The Court held that the bar's use of compulsory dues to finance activities having "political or ideological coloration" violated the First Amendment, *except* when such expenditures were reasonably or necessarily incurred for the purpose of regulating the legal profession or improving the quality of legal services available to the people of the state. *Keller*, 496 U.S. at 14, 110 S.Ct. at 2236; *see also Lathrop v. Donohue*, 367 U.S. 820, 843, 81 S.Ct. 1826, 1838, 6 L.Ed.2d 1191 (1961). The undisputed purpose of the IOLTA Program is to provide funding for legal services to a substantial segment of the population of Texas. This squarely fits within the purview of improving the quality of the legal service available to the people of the state as contemplated by *Keller*. Furthermore, the extent of an attorney's involvement with the IOLTA Program is merely handling his client's funds in a slightly different fashion than he would otherwise. There is no contribution of the

attorney's own funds or his or her bar dues. Accordingly, the Court finds no constitutional infirmity with respect to attorneys' mandatory participation in the IOLTA Program.

Because the Court does not find that the IOLTA Program adversely impacts the Plaintiffs' rights either under the First or Fifth Amendment, the Court will not delve into extended First Amendment analysis regarding whether the Program is adequately tailored to serve the state's claimed interest. It suffices to say that providing indigent Texans with the means to gain access to the legal system is a significant state interest and the operation of the system imposes minimal burdens upon First Amendment rights of attorneys and their clients. *See, generally, Hays County Guardian v. Supple*, 969 F.2d at 122-24.

ELEVENTH AMENDMENT AND 42 U.S.C. § 1983 IMMUNITY

The Defendants also argue that they are entitled to Eleventh Amendment immunity and that they are not "persons" for purposes of 42 U.S.C. § 1983.

Eleventh Amendment Immunity

The Eleventh Amendment generally divests federal courts of jurisdiction to entertain suits directed against states. *Green v. State Bar of Texas*, 27 F.3d 1083, 1087 (5th Cir.1994) (*citing Port Auth. Trans-Hudson Corp. v. Feeney*, 495 U.S. 299, 304, 110 S.Ct. 1868, 1971, 109 L.Ed.2d 264 (1990)). Unless consent is given, the Eleventh Amendment forbids suit against a state, a state agency or department of the state by citizens of the state. *Pennhurst State School & Hosp. v. Halderman*, 465 U.S. 89, 100, 104 S.Ct. 900, 907, 79 L.Ed.2d 67 (1984). Suit is barred against a state entity regardless of whether money damages or injunctive relief is sought. *Clark v. Tarrant County, Texas*, 798 F.2d 736, 743 (5th Cir. 1986); *Krempp v. Dobbs*, 775 F.2d 1319, 1321 (5th

Cir.1985); *Cory v. White*, 457 U.S. 85, 102 S.Ct. 2325, 72 L.Ed.2d 694 (1982).

In a suit challenging a rule of a state supreme court, the supreme court is the real party in interest if it has the ultimate authority to adopt and enforce the rule in question. *Lewis v. Louisiana State Bar Ass'n*, 792 F.2d 493, 497 (5th Cir.1986). In such an instance, moreover, an entity whose role is completely defined by the state supreme court, which acts as the agent of the court, occupies the position of a public agency for purposes of Eleventh Amendment analysis. *See Lewis v. Louisiana State Bar Ass'n*, 792 F.2d 493 (5th Cir.1986) (Louisiana Supreme Court and state bar association both entitled to Eleventh Amendment immunity from action by unsuccessful bar applicant's due process complaint); *accord Krempp v. Dobbs*, 775 F.2d at 1321. (Suit against Texas State Bar and State Commission on Judicial Conduct barred by Eleventh Amendment).

As noted above, the TEAJF was created by an order of the Texas Supreme Court in 1988, pursuant to the court's inherent power to regulate the practice of law in Texas. Pursuant to that order, the TEAJF has statewide authority to act and carries out its objectives on a statewide basis. Consistent with the logic of *Lewis*, the Court finds that the TEAJF is an arm of the Texas Supreme Court, and consequently the State of Texas, thereby entitling the TEAJF to Eleventh Amendment protection from all of the Plaintiffs' claims.

However, the Eleventh Amendment does not bar suits for injunctive relief against state officials. *Word of Faith World Outreach Ctr. v. Morales*, 986 F.2d 962, 965 (5th Cir.), *cert. denied*, —— U.S. ——, 114 S.Ct. 82 126 L.Ed.2d 50 (1993); *Ex Parte Young*, 209 U.S. 123, 28 S.Ct. 441, 52 L.Ed. 714 (1908). Accordingly, to the extent that the Plaintiffs' complaint seeks injunctive relief against the Chairman of the TEAJF, such claims are permitted under the Eleventh Amendment.

42 U.S.C. § 1983

A state official acting in his official capacity is not a person under § 1983 unles the relief requested in a suit against him in this capacity is prospective relief. *John G. and Marie Stella Kenedy Mem. Found. v. Mauro*, 21 F.3d 667, 671 (5th Cir.), *cert. denied*, —— U.S. ——, 115 S.Ct. 577, 130 L.Ed.2d 493 (1994); *Will v. Michigan Dep't of State Police*, 491 U.S. 58, 71 & n. 10, 109 S.Ct. 2304, 2312 & n. 10, 105 L.Ed.2d 45 (1989). Accordingly, to the extent the Plaintiffs seek prospective relief against the Chairman of the TEAJF, Dean Frank Newton, such claims may proceed; however, any monetary relief is barred.[16]

CONCLUSION

The Court declines to address the expressed social, political or public policy concerns related to the current operational procedures of the Texas Equal Access to Justice Foundation as it administers the IOLTA Program. Alleviation of these concerns rests with Texas attorneys and their relationship to the state bar, as well as the care of all Texas voters in the selection of their elected public officials.

Based upon the foregoing analysis, the Court finds that the Defendants' Motions for Summary Judgment should be granted, and the Plaintiffs' claims should be dismissed in their entirety. Further, the Court finds that the Plaintiffs' Motion for Summary Judgment should be denied.

THEREFORE, IT IS ORDERED that the Motion for Summary Judgment, filed by the Texas Equal Access to

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[16] The parties do not address whether the individual justices of the Texas Supreme Court are entitled to Eleventh Amendment Immunity or are persons for § 1983 purposes. However, the Court finds that were these issues before it, the same analysis would apply—i.e., the Plaintiffs claims for injunctive remedies may be sought against the individual Justices.

Justice Foundation on December 6, 1994, is hereby GRANTED.

FURTHER, IT IS ORDERED that the Motion for Summary Judgment, filed by the Supreme Court Defendants on December 6, 1994, is hereby GRANTED.

FURTHER IT IS ORDERED that the Motion for Summary Judgment, filed by the Plaintiffs on December 8, 1994 is hereby DENIED.

ACCORDINGLY, IT IS ORDERED, ADJUDGED AND DECREED that any and all claims brought by the Plaintiffs against the Defendants in the above-numbered and styled cause of action are hereby DISMISSED WITH PREJUDICE.

FURTHER, IT IS ORDERED, ADJUDGED AND DECREED that the above-numbered and styled cause of action is hereby DISMISSED WITH PREJUDICE.

FINALLY, IT IS ORDERED that Clerk shall TERMINATE AS MOOT any motions that remain pending in this action.

APPENDIX C

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 95-50160

WASHINGTON LEGAL FOUNDATION;
WILLIAM R. SUMMERS; MICHAEL J. MAZZONE,
Plaintiffs-Appellants,

v.

TEXAS EQUAL ACCESS TO JUSTICE FOUNDATION; W. FRANK NEWTON, Chairman, Texas Equal Access to Justice Foundation; THOMAS R. PHILLIPS, Chief Justice; RAUL GONZALEZ, Justice; JACK HIGHTOWER, Justice; NATHAN L. HECHT, Justice; LLOYD A. DOGGETT, Justice; BOB GAMMAGE, Justice; CRAIG T. ENOCH, Justice; JOHN CORNYN, Justice; ROSE SPECTOR, Justice; SUPREME COURT DFTS,
Defendants-Appellees.

Appeal from the United States District Court
for the Western District of Texas
James R. Nowlin, Judge

Feb. 14, 1997

ON PETITIONS FOR REHEARING AND
SUGGESTIONS FOR REHEARING EN BANC

Before WISDOM, GARWOOD and JONES, Circuit Judges.

PER CURIAM:

A member of the court in active service having requested a poll on the reconsiderations of this cause en banc, and a majority of the judges in active service not having voted in favor, Rehearings En Banc are DENIED.

POLITZ, Chief Judge, and KING, WIENER, BENAVIDES, STEWART and PARKER, Circuit Judges, dissent from the refusal of the court to grant rehearing en banc.

BENAVIDES, Circuit Judge, joined by POLITZ, Chief Judge, and STEWART and PARKER, Circuit Judges, dissenting from failure to grant rehearing en banc:

In the subject case, a panel of this court held that "clients . . . have a cognizable property interest in the interest proceeds that are earned on their deposit in IOLTA accounts." 94 F.3d 996, 1005 (5th Cir.1996). In reaching this conclusion, the panel relied upon the traditional rule applied in Texas that "interest follows principal," which recognizes that interest earned on a deposit belongs to the owner of the principal. *Id.* at 1000. The panel also relied upon the Supreme Court's opinion in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, which in turn relied upon the same state law rule to hold that "earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." *Id.* at 1002 (quoting 449 U.S. 155, 164, 101 S.Ct. 446, 452-53, 66 L.Ed.2d 358 (1980)).

This decision is an important one because it contradicts every other court in the country that has addressed this issue, including two of our sister circuits and a large number of state appellate courts.[1] Moreover, while purporting to resolve only a threshold issue in this case, the opinion is bound to create difficulties and confusion for the district court on remand. Finally, this case poses an unwarranted threat to a primary source of funding for public interest legal organizations in this circuit at a time when these organizations are already struggling for their lives financially. For the foregoing reasons, I believe that this case is worthy of our en banc consideration and respectfully dissent from the contrary conclusion of my colleages.

I.

Texas is one of fifty states that operates an Interest on Lawyers Trust Account Program ("IOLTA"). The IOLTA concept is possible because there are situations in which the costs of maintaining funds held by lawyers for their clients exceed the interest that a client can earn from a financial institution. When the amount of a client's funds to be held is nominal or when a client's funds will be held for a brief period of time, the deposit of a client's funds acts as an interest-free loan to the bank. IOLTA is an attempt to transfer this benefit from banks to legal providers for the indigent. The Texas IOLTA program has been a resounding success, raising approximately $10 million per year for legal services organizations in the state.

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[1] *See Washington Legal Fdn. v. Mass. Bar Fdn.*, 993 F.2d 962 (1st Cir.1993); *Cone v. State Bar of Fla.*, 819 F.2d 1002 (11th Cir.), *cert. denied*, 484 U.S. 917, 108 S.Ct. 268, 98 L.Ed.2d 225 (1987); *Carroll v. State Bar of Cal.*, 166 Cal.App.3d 1193, 213 Cal.Rptr. 305 (Cal.Ct.App.1984), *cert. denied*, 474 U.S. 848, 106 S.Ct. 142, 88 L.Ed.2d 118 (1985); *Petition by Mass. Bar Ass'n*, 395 Mass. 1, 478 N.E.2d 715 (1975); *In re Interest on Lawyers' Trust Accounts*, 279 Ark. 84, 648 S.W.2d 480 (1983); *In re Adoption of Amendments to C.P.R.D.R. 9-102 IOLTA*, 102 Wash.2d 1101 (Wash. 1984); *In re Lawyers' Trust Accounts*, 672 P.2d 406 (Utah 1983); *In re New Hampshire Bar Ass'n*, 122 N.H. 971, 453 A.2d 1258 (1982); *In re Minnesota State Bar Ass'n*, 332 N.W.2d 151 (Minn. 1982); *In re Interest on Trust Accounts*, 402 So.2d 389 (Fla.1981).

The plaintiffs brought this action because of their objections to the activities of the recipients of IOLTA funds.[2] *Washington Legal Fdn.*, 94 F.3d at 999. The plaintiffs contend that the IOLTA program constitutes an unconstitutional taking of property, in violation of the Fifth Amendment to the United States Constitution, and that the program violates the First Amendment because it forces them to support speech they find offensive. The plaintiffs seek an injunction against further operation of the Texas IOLTA program and compensation for any interest earned on their deposits into IOLTA accounts.

The district court concluded that the plaintiffs' constitutional challenges failed at the threshold because the plaintiffs could not establish a property interest in the earnings from funds deposited in IOLTA accounts. The district court, therefore, granted summary judgment in favor of the defendants. On appeal, a panel of this court reversed the decision of the district court and remanded the case for further proceedings.

II.

"The pertinent words of the Fifth Amendment of the Constitution of the United States are the familiar ones: 'nor shall private property be taken for public use, without just compensation.'" *Webb's Fabulous Pharmacies*, 449 U.S. at 160, 101 S.Ct. at 450. In order to prevail on a takings clause claim, a plaintiff must establish an interest in private property. "Property interests . . . are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or under-

[2] IOLTA rules provide that "[t]he Foundation shall make grants to organizations . . . hav[ing] as a primary purpose the delivery of legal services to low income persons. . . ." TEXAS RULES OF COURT-STATE, Rules Governing the Operation of the Texas Equal Access to Justice Foundation ("IOLTA Rule"), Rule 10 (West 1996). Eligible recipient organization "shall use such funds to provide legal services to individual indigent persons." IOLTA Rule 11.

standings that stem from an independent source such as state law." *Board of Regents v. Roth*, 408 U.S. 564, 577, 92 S.Ct. 2701, 2709, 33 L.Ed.2d 548 (1972). "But a mere unilateral expectation or an abstract need is not a property interest entitled to protection." *Webb's Fabulous Pharmacies*, 449 U.S. at 161, 101 S.Ct. at 451.

At the outset, it is important to draw a distinction never addressed by the panel between "accrued interest" and "interest proceeds." The panel correctly noted that accrued interest is always created by funds deposited in a bank. *See Washington Legal Fdn.*, 94 F.3d at 1003. The IOLTA concept is simply an attempt to transfer this accrued interest from banks to legal aid organizations. Interest proceeds, however, are the amount of accrued interest that remains after deducting the costs of administering a deposited fund. It is undisputed that a client's funds may be deposited in an IOLTA account only if they are incapable of producing interest proceeds because of the nominal amount or the short duration of the deposit.[3]

[3] IOLTA Rule 6 provides, in part:

> The funds of a particular client are nominal in amount or held for a short period of time, and thus eligible for use in the Program, if such funds, considered without regard to funds of other clients which may be held by the attorney, . . . could not reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client.

It is worth noting that whether attorneys correctly apply the requirements of Rule 6 is irrelevant to the constitutional issue resolved by the panel's opinion. If attorneys violate IOLTA's rules by depositing ineligible funds, it seems that any action a client might have would be against her attorney. To the extent the state may be implicated, this is certainly not because IOLTA's rules result in the taking of a client's property, but rather because IOLTA's rules were not followed.

A careful reading of *Webb's* makes clear that the existence of interest proceeds to which the depositors were entitled was a prerequisite to the Court's decision. In reaching its conclusion that creditors had a cognizable property right to the interest from an interpleader fund deposited with the court clerk for their benefit, the Court held that "[t]he *earnings* of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property." *Webb's Fabulous Pharmacies*, 449 U.S. at 164, 101 S.Ct. at 452 (emphasis added). A clear implication of this holding is that if a fund generates no earnings to which its owner is entitled, there is no cognizable property interest.

Moreover, when the Court discussed whether the creditors had a property interest in the principal of the interpleader fund, the Court recognized that "[i]t is true, of course, that none of the creditor claimants had any right to the deposited fund until their claims were recognized and distribution was ordered." *Id.* at 161, 101 S.Ct. at 451 (citation omitted). In concluding that the creditors did in fact have a property interest, the Court was careful to note that "[e]ventually, and inevitably, that fund, less proper charges authorized by the court, would be distributed among the creditors as their claims were recognized by the court." *Id.* This language makes clear that the Court will not recognize a constitutionally cognizable interest in the principal of a deposited fund unless and until it is clear that the funds will be distributed as proceeds to its beneficiary. Therefore, when the Court later concluded that earnings from such a fund are property "just as the fund itself is property," *id.* at 164, 101 S.Ct. at 452, the Court strongly suggested that interest proceeds are a necessary prerequisite to a constitutionally cognizable property interest in the earnings from a deposited fund.

Finally, the Court was careful to limit its holding to cases in which a separate statute authorizes the state to subtract its administrative costs. *See id.* at 164-65, 101

S.Ct. at 452-53. In those cases it is clear that interest proceeds exist because the costs of administering the fund have already been subtracted from the accrued interest generated by the fund. Therefore, it is equally clear that the fund's owner has been deprived of a property interest. In cases where "double tolling" of this sort does not occur, it cannot be so easily determined whether the fund's owner has been deprived of interest proceeds to which she is entitled. It is clear to me that the Court limited its holding because a bright-line rule establishing a property interest in this latter situation would be inappropriate.

Similarly, it follows that the state law rule that "interest follws principal" controls only when interest is earned on the principal or, in other words, when interest proceeds are available.[4] Consider the fate of the plaintiffs' accrued interest in the absence of IOLTA. Because the costs of administering the deposited funds would exceed any interest earned by a client, the bank would keep the accrued interest. Are the banks violating the traditional state law rule? Are the banks somehow converting or stealing the clients' property? The answer of course is no—because the clients had no interest in property to take.

III.

The panel attempted to avoid this reality by claiming that a bank assigns interest to a depositor in a two-part process. *See Washington Legal Fdn.*, 94 F.3d at 1003. According to the panel, a bank attributes interest to an account prior to deducting any of its fees. *Id.* From this, the court concluded that "a property interest attaches the moment that the interest accrues . . . ." *Id.*

Even if the panel presents an accurate picture of banking practices, however, those practices are beside the point.

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[4] The *Webb's* Court's limitation of its holding would have been unnecessary if the "interest follows principal" rule results in the creation of a property interest irrespective of the costs associated with administering accrued interest.

For purposes of a takings clause challenge, a constitutionally cognizable interest in property does not exist in "earnings" from a deposited fund unless and until those earnings can be distributed as proceeds to the fund's beneficiary. Because IOLTA-eligible funds would never produce interest proceeds, earnings from such funds cannot be distributed to the funds' owners. For this reason, the panel's conclusion that a property interest was created after the first step in the bank's process of assigning interest is simply wrong.

The fact that interest proceeds are created by the Texas IOLTA program does not weaken this conclusion. Rather, the simple recognition that without IOLTA there would be no interest proceeds compels it. The plaintiffs in this case are not harmed in any way by the existence of IOLTA and would not be benefitted in any tangible way by its elimination. I find it both ironic and fatal to the plaintiffs' claim that in order to have a property interest in this case, they must rely on the existence of the program they seek to eliminate.

In addition to being consistent with a fair interpretation of the legal authority relied upon by the panel, rejection of the plaintiffs' asserted property interest in this case is consistent with the protections underlying the Takings Clause. The Takings Clause provides that "private property [shall not] be taken for public use, without just compensation." U.S. CONST. amend. V. While beneficial use of property is certainly not essential to the existence of a property interest worthy of the protections of this provision, such an interest does require that the property at issue have some actual or potential *compensable* value that could accrue to the benefit of its owner. In addition, a primary purpose of the Takings Clause is to protect the investment-backed expectations of property owners that their property will not be taken for public use without just compensation.[5]

[5] In *Lucas v. South Carolina Coastal Council*, Justice Scalia noted that the Court has "acknowledged time and again, '[t]he economic impact of the regulation on the claimant and . . . the extent to which the regulation has interfered with distinct investment-backed expectations' are keenly relevant to takings analysis generally." 505 U.S. 1003, 1019 n. 8, 112 S.Ct. 2886, 2895 n. 8, 120 L.Ed.2d 798 (1992) (quoting *Pennsylvania Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 124, 98 S.Ct. 2646, 2659, 57 L.Ed.2d 631 (1978)).

Unless the owner of a fund deposited in an IOLTA account could reasonably expect to receive interest proceeds (of any amount) from her earnings, the client's "property" does not have any compensable value. Moreover, the fact that the client does not receive any interest proceeds from her deposited funds does not interfere with her investment-backed expectations because she could not have reasonably expected to receive any net interest when the deposit was made. In my view, these unusual circumstances prevent the client from asserting a constitutionally cognizable interest in property.

This understanding of the Takings Clause is buttressed by the available remedy for plaintiffs whose property has been unconstitutionally taken. Such plaintiffs are entitled to just compensation, i.e., the fair market value of their property. Because the fair market value of the earnings of IOLTA-eligible funds is $0, the client would be entitled to nothing. In sum, applying Fifth Amendment protections to an asserted property interest that does not have any compensable value is not consistent with the purposes that underlie the Takings Clause—to compensate a property owner for the value of her property that was taken for public use.

IV.

In addition to creating a circuit split, misinterpreting the legal authority upon which it relied, and applying a takings clause analysis to governmental action that does not implicate relevant Fifth Amendment values, the panel's analysis can only create confusion for the district court on remand. The Supreme Court's cases dealing with the Tak-

ings Clause fit roughly into the two categories of regulatory takings and per se takings. *See* JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW § 11.12, at 462-66 (5th ed. 1995). Regulatory takings involve governmental regulations that impinge upon a property owner's economic interests. In regulatory takings cases, the Court has adopted a balancing test whereby it weighs the economic impact of the regulation on the property owner suffering the loss against the public benefits of the regulation. *See, e.g., Pennsylvania Cent. Transp. Co.*, 438 U.S. at 124, 98 S.Ct. at 2659. Viewed as a regulatory takings case, IOLTA clearly passes muster because the clients have suffered no economic loss and the public has greatly benefitted. *See Massachusetts Bar Fdn.*, 993 F.2d at 976 (noting that Massachusetts's IOLTA program has no economic impact on clients and does not interfere with their investment-backed expectations).

Per se takings involve what might be considered a "literal" taking of property. The Court adopts a per se approach and finds a compensable taking of property without a case-by-case inquiry. *See* NOWAK & ROTUNDA, *supra*, § 11.12, at 463-64. The Court has adopted a per se approach if a regulation deprives an owner of the entire value of her property. *Id.* (citing *Lucas*, 505 U.S. at 1003, 112 S.Ct. at 2886). The Court has also adopted a per se approach if the governmental action results in physical occupation of property or a permanent change in rights of ownership. *Id. at* 464 (citing *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 102 S.Ct. 3164, 73 L.Ed.2d 868 (1982)). Viewed as a per se takings case whereby the clients have a property interest that is literally appropriated by the state, IOLTA is almost certainly unconstitutional.

Webb's was clearly a per se takings case. The Court's entire opinion is dedicated to determining that the creditors had a property right in the principal and interest proceeds of the subject interpleader fund. *See* 449 U.S. at

156-64, 101 S.Ct. at 448-53. Because this property was appropriated by the state for its own purposes, a literal taking of the property occurred. This latter conclusion required no separate analysis by the Court and accordingly was given none. *See id.* at 164-65, 101 S.Ct. at 452-53.

The panel's opinion in the instant case gave no explicit indication whether the court viewed the case as a regulatory or per se takings case. If the panel viewed this case as one involving a regulatory taking, it should have made this clear in its remand order and should not have relied on *Webb's*. On the other hand, if the panel regarded the case as one involving a per se taking, it should not have bifurcated the inquiries regarding whether the clients had a property right and whether a taking of that property occurred. An affirmative answer to the second question would necessarily follow from an affirmative answer to the first.

The panel's opinion implicitly indicated that it left open the question of whether the case should be viewed as a regulatory takings case or as a per se takings case. The panel noted that "to prevail on their taking claim, the plaintiffs must demonstrate that the taking was against the will of the property owner." *Washington Legal Fdn.*, 94 F.3d at 1004. In addition, the court cited *Yee v. City of Escondido*, 503 U.S. 519, 539, 112 S.Ct. 1522, 1534-35, 118 L.Ed.2d 153 (1992), which held that "because [a city's] rent control ordinance [did] not compel a landowner to suffer the physical occupation of his property, it [did] not effect a per se taking . . . ." While the applicablity of this decision to the context of deposited funds is not clear, it does leave open the possibility that a per se taking did not occur in the subject case because clients voluntarily deposit their money with an attorney (who, in turn, deposits eligible funds into an IOLTA account). The fact remains, however, that *Webb's*, the principal case relied upon by the panel, was a per se takings case. Be-

cause I abide by my concerns regarding the panel's conclusion that the plaintiffs asserted a constitutionally cognizable property interest in the accrued interest from IOLTA deposits, I would not burden the district court with this confusion.

V.

The issue addressed by the panel in the subject case raises very difficult and interesting conceptual issues regarding the proper definition of property for Fifth Amendment purposes. Three judges in this circuit have concluded that the plaintiffs have asserted a constitutionally cognizable property interest in the earnings from IOLTA-eligible funds, despite the inability of such funds to produce interest proceeds. I disagree with that conclusion, as has every other court to have addressed the issue. Moreover, the panel's decision on this "threshold issue" will have important implications for the disposition of this case on remand and, ultimately, for the constitutionality of the IOLTA programs in Louisiana, Mississippi, and Texas. For these reasons, I believe that the intellectual efforts of our court's entire membership would have benefitted the decision making process in this clearly important case. I regret my colleagues' decision to deny rehearing en banc and respectfully dissent.

APPENDIX D

CONSTITUTIONAL PROVISIONS AND FEDERAL STATUTE INVOLVED

AMENDMENT I—FREEDOM OF RELIGION, SPEECH AND PRESS; PEACEFUL ASSEMBLAGE; PETITION OF GRIEVANCES

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.

AMENDMENT V—GRAND JURY INDICTMENT FOR CAPITAL CRIMES; DOUBLE JEOPARDY; SELF-INCRIMINATION; DUE PROCESS OF LAW; JUST COMPENSATION FOR PROPERTY

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

12 U.S.C. § 1832 Withdrawals by negotiable or transferable instruments for transfers to third parties

(a) Authority of depository institution; applicability

(1) Notwithstanding any other provision of law but subject to paragraph (2), a depository institution is authorized to permit the owner of a deposit or account on

which interest or dividends are paid to make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third parties.

(2) Paragraph (1) shall apply only with respect to deposits or accounts which consist solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, political, or other similar purposes and which is not operated for profit, and with respect to deposits of public funds by an officer, employee, or agent of the United States, any State, county, municipality, or political subdivision thereof, the District of Columbia, the Commonwealth of Puerto Rico, American Samoa, Guam, any territory or possession of the United States, or any political subdivision thereof.

(b) Definition

For purposes of this section, the term "depository institution" means—

(1) any insured bank as defined in section 1813 of this title;

(2) any State bank as defined in section 1813 of this title;

(3) any mutual savings bank as defined in section 1813 of this title;

(4) any savings bank as defined in section 1813 of this title;

(5) any insured institution as defined in section 1724 of this title; and

(6) any building and loan association or savings and loan association organized and operated according to the laws of the State in which it is chartered or organized; and, for purposes of this paragraph, the term "State" means any State of the United States, the District of Columbia, any territory of the United

States, Puerto Rico, Guam, American Samoa, or the Virgin Islands.

(c) Fine

Any depository institution which violates this section shall be fined $1,000 for each violation.

APPENDIX E

EXCERPT FROM TEXAS SUPREME COURT ORDER ADOPTING STATE BAR RULES ESTABLISHING TEXAS IOLTA PROGRAM

Article XI

INTEREST EARNED ON CLIENT FUNDS HELD BY ATTORNEYS

Section 1. Short Title

This Article may be referred to as the Texas Equal Access to Justice Program.

Section 2. Findings; Purpose

The Supreme Court of Texas finds that:

(A) On certain client funds held by attorneys, interest income cannot reasonably be earned to benefit individual clients for whom the funds are held;

(B) income can be earned on those client funds pursuant to the program provided for in this Article and that income should be used to provide additional legal services to the indigent in civil matters;

(C) this Court is the proper and appropriate body, through the adoption of rules as set forth in this Article, to create and administer, or cause to be created and administered, a program to carry out the purposes of this Article; and

(D) this Article is adopted in furtherance of the inherent powers of this Court to regulate the practice of law in the State of Texas.

APPENDIX F

SELECT TEXAS IOLTA PROGRAM RULES

RULE 4. DEPOSIT OF CERTAIN CLIENT FUNDS

An attorney licensed by the Supreme Court of Texas, receiving in the course of the practice of law in this state client funds that are nominal in amount or are reasonably anticipated to be held for a short period of time, must establish and maintain a separate interest-bearing insured depository account at a financial institution and deposit in the account such funds. All client funds may be deposited in a single unsegregated account. Attorneys who practice in a law firm or for a professional corporation may utilize the interest-bearing trust account of such firm or corporation to comply with this Rule 4. The interest earned on the account shall be paid in accordance with and used for the purposes set forth in these Rules. The Foundation shall hold the entire beneficial interest in the interest earned. Funds to be deposited under these Rules shall not include those funds evidenced by a financial institution instrument, such as a draft, until the instrument is fully credited to the financial institution in which the account is maintained. The term "draft" as herein used is defined in Section 3.104(b)(1) of the Texas Business and Commerce Code. A draft or similar instrument need not be treated as a collected item unless it is the type of instrument which the financial institution generally treats as a collected item.

RULE 6. FUNDS ELIGIBLE FOR THE PROGRAM

The funds of a particular client are nominal in amount or held for a short period of time, and thus eligible for use in the Program, if such funds, considered without regard to funds of other clients which may be held by the attorney, law firm or professional corporation, could not

reasonably be expected to earn interest for the client or if the interest which might be earned on such funds is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain interest on such funds for the client. Also to be considered are the nature of the proceeding or transaction involved and the likelihood of delay in the need for such funds in such proceeding or transaction. The attorney, law fim or professional corporation should exercise good faith judgment in determining initially whether client funds should be included in the Program and should review at reasonable intervals whether changed circumstances require further action with respect to such funds.

RULE 9. DIRECTIONS TO DEPOSITORIES

The depository institution shall be directed by the attorney, law firm or professional corporation establishing the account:

(a) to remit, at least quarterly, interest earned on the average daily balance in the account, less reasonable service charges, to the Foundation;

(b) to transmit to the Foundation with each remittance a statement showing the name of the attorney, law firm or professional corporation with respect to which the remittance is sent, the rate or rates of interest applied, and the amount of service charges deducted, if any; and

(c) to transmit to the depositing attorney, law firm or professional corporation at the same time a report is sent to the Foundation, a report showing the amount paid to the Foundation for that period, the rate or rates of interest applied, the amount of service charges deducted, if any, and the average daily account balance for each month of the period for which the report is made.

APPENDIX G

TEXAS DISCIPLINARY RULES REGARDING MANAGEMENT OF CLIENT FUNDS

Supreme Court of Texas, State Bar Rules, art. X, § 9 Rule 1.14:

RULE 1.14 SAFEKEEPING PROPERTY

(a) A lawyer shall hold funds and other property belonging in whole or in part to clients or third persons that are in a lawyer's possession in connection with a representation separate from the lawyer's own property. Such funds shall be kept in a separate account, designated as a "trust" or "escrow" account, maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Other client property shall be identified as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of five years after termination of the representation.

(b) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.

(c) When in the course of representation a lawyer is in possession of funds or other property in which both the lawyer and another person claim interests, the property shall be kept separate by the lawyer until there is an accounting and severance of their interest. All funds in a trust or escrow account shall be disbursed only to those

persons entitled to receive them by virtue of the representation or by law. If a dispute arises concerning their respective interests, the portion in dispute shall be kept separate by the lawyer until the dispute is resolved, and the undisputed portion shall be distributed appropriately.

Supreme Court of Texas, Code of Professional Responsibility, DR 9-102 (Former Rule):

DR 9-102. Preserving Identity of Funds and Property of a Client.

(A) All funds of clients paid to a lawyer or law firm, other than advances for costs and expenses, shall be deposited in one or more identifiable bank accounts maintained in the state in which the law office is situated and no funds belonging to the lawyer or law firm shall be deposited therein except as follows:

(1) Funds reasonably sufficient to pay bank charges may be deposited therein.

(2) Funds belonging in part to a client and in part presently or potentially to the lawyer or law firm must be deposited therein, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

(B) A lawyer shall:

(1) Promptly notify a client of the receipt of his funds, securities, or other properties.

(2) Identify and label securities and properties of a client promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable.

(3) Maintain complete records of all funds, securities, and other properties of a client coming

into the possession of the lawyer and render appropriate accounts to his client regarding them.

(4) Promptly pay or deliver to the client as requested by a client the funds, securities, or other properties in the possession of the lawyer which the client is entitled to receive.